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In the

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-472

WALTER J. WOODMAN, et al.,

Petitioners,

v.

W. D. AMASON, et al.,

Respondents.

ON A WRIT OF CERTIORARI TO THE SUPREME COURT OF TEXAS

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INDEX

	Page
List of Authorities	ii
Opinion Citation	1
Jurisdiction	1
Questions Presented	2
Statutes Involved	3
Statement	3-10
Reasons for Granting the Writ	12-23
Importance	23
Conclusion	24
Appendix	A-1 - A-13
Certificate of Service	24

Page

United States Constitution

Fifth Amendment 21

Fourteenth Amendment 21

United States Supreme Court Cases

Armstrong v. Ashley, 204 U. S. 272, 27 S. Ct. 270, 51 L. Ed. 482 13

Smith v. Orton, 21 How 241, 16 L. Ed. 104 ..... 13, 14, 22

U. S. v. California & O. Land Co., 148 U. S. 31, 13 S. Ct. 458, 37 L. Ed. 354 ..... 13, 14

Ochoa v. Hernandez y Morales, 230 U. S. 139, 33 S. Ct. 1033, 57 L. Ed. 1427 14

Onraha Hotel Co. v. Wade, 97 U.S. 13, 24 L. Ed. 917 14

U. S. v. Linn, 1 How 104, 11 L. Ed. 64 14

Great Northern R. Co. v. Hower, 236 U. S. 702, 35 S. Ct. 465, 59 L. Ed. 798 14

Moelle v. Sherwood, 149 U. S. 21, 13 S. Ct. 426, 37 L. Ed. 350 14

Warner v. Morton, 20 How 448, 15 L. Ed. 950 15

Selma, R. & D. R. Co. v. U. S., 139 U. S. 650, 11 S. Ct. 638, 35 L. Ed. 266 15

U. S. v. Denver R. G. R. Co., 191 U. S. 84, 24 S. Ct. 33, 48 L. Ed. 106 15

Angle v. Northwestern L. Ins. Co., 92 U. S. 330, 23 L. Ed. 556 15

Brush v. Ware, 15 Pet. 93, 10 L. Ed. 672 15

Simmons Creek Coal Co. v. Doran, 142 U. S. 417, 12 S. Ct. 239, 35 L. Ed. 1063 15

Joy v. St. Louis, 138 U. S. 1, 11 S. Ct. 243, 34 L. Ed. 843 16

Page

May v. LeClaire, 11 Wall 217, 20 L. Ed. 50 16

Rogers v. Palmer, 102 U. S. 263, 26 L. Ed. 164 16

Link v. Wabash R. Co., 370 U. S. 626, 82 S. Ct. 1368, 8 L. Ed. 2d 734 16

Castle v. Bullard, 23 How 172, 16 L. Ed. 424 16

Wecker v. National Enameling & Stamping Co., 204 U. S. 176, 27 S. Ct. 184, 51 L. Ed. 436 16

Chapman v. Sheridan Wyo. Coal Co., 338 U. S. 621, 70 S. Ct. 392, 94 L. Ed. 393 16

Jennison v. Leonard, 21 Wall 302, 22 L. Ed. 539 17

Bissell v. Heyward, 96 U. S. 580, 24 L. Ed. 678 17

Gunton v. Carroll, 101 U. S. 426, 5 L. Ed. 985 17

Barbier v. Connolly, 113 U. S. 27, 5 S. Ct. 357, 28 L. Ed. 923 21

Texas Cases

Bethea v. Lockhart (Tex. Civ. App. 1939) 127 S.W. 2d 1029, Ref. 3

Crain v. Firemen's & Policemen's Civil Service Com'n. (Tex. Civ. App. 1973) 495 S.W. 2d 20 8

Gulf Production Co. v. Continental Oil Co. (Tex. Sup. Ct. 1939) 132 S.W. 2d 553 ..... 9, 11

Forister v. Coleman (Tex. Civ. App. 1967) 418 S.W. 2d 550, Ref., n.r.e. 431 S.W. 2d 2 13

Valley Ready-Mix Concrete v. Valley State Bank (Tex. Civ. App. 1950) 227 S.W. 2d 231 14

Hexter v. Pratt (Tex. Com. App. 1928) 10 S.W. 2d 692 16

Patrick v. Webb (Tex. Civ. App. 1963) 369 S.W. 2d 446, 449 Ref., n.r.e. 19

Barnum v. Lopez (Tex. Sup. Ct. 1971) 471 S.W. 2d 567 19

List of Authorities — (Continued)

	Page
Smith v. Williams (Tex. Sup. Ct. 1967) 422 S.W. 2d 168	20
MacDonald v. Painter (Tex. Sup. Ct. 1969) 441 S.W. 2d 179	20
Burns v. Woods (Tex. Sup. Ct. 1973) 492 S.W. 2d 940	20
Federal	
15 U.S.C. Sec. 1401 et seq.	4
Texas	
Vernon's Ann. Civ. St. art. 1101a	4
Vernon's Ann. Civ. St. art. 1133	4
Vernon's Ann. Civ. St. art. 6626	2, 3, 5, 20, 21
Vernon's Ann. Civ. St. art. 6603	5
Tex. Rules of Civil Procedure, Rule 505	2, 20
Other	
Clark, Real Covenants and Other Interests Which "Run With Land" (1947)	9
Pomeroy: A Treatise on Equity Jurisprudence, Vol. III (1941)	8, 9, 17, 18

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Respondents.

ON A WRIT OF CERTIORARI TO THE SUPREME COURT OF TEXAS

The opinion of the Court of Civil Appeals of Texas at Waco, affirming the trial court, is found in 484 S.W. 2d 594. (Opinion fully printed in Appendix, pages A-1 to A-4.) The opinion of the Supreme Court of Texas reversing and rendering judgment for the Respondents is found in 16 THE TEXAS SUPREME COURT JOURNAL 321, ... S.W. 2d ... ..., (opinion not yet printed in Reporter series, opinion fully printed in Appendix, pages A-6 to A-10).

JURISDICTION

The opinion and judgment of the Supreme Court of Texas was entered on May 2, 1973 (Record 22, 23, Appendix A-11 to A-12). The Petitioners duly filed a Motion for Rehearing in

the Supreme Court of Texas, which was overruled on June 13, 1973 (Record 26, Appendix A-13). Notice of Appeal to this Court was filed with the Supreme Court of Texas on June 19, 1973 (Record 29). This appeal is perfected from the Order overruling the Motion for Rehearing and the jurisdiction of this Court is invoked under Title 28 United States Code Annotated, Section 1257 (2) and (3).

QUESTIONS PRESENTED

1. That the Supreme Court of Texas denied Petitioners due process of law and equal protection of the law under the Fifth and Fourteenth Amendments to the United States Constitution when they ruled that the burden of proof to prove Respondents did not possess actual knowledge of certain unrecorded contracts of sale was upon Petitioners.

2. That the Supreme Court of Texas denied Petitioners due process of law and equal protection of the law under the Fifth and Fourteenth Amendments to the United States Constitution in rendering judgment against Petitioners after having reversed the judgments of the lower courts on law that had not previously been applicable to the facts of the case herein; the proper course for the Supreme Court of Texas in such a case being to have remanded for a new trial.

3. That the Supreme Court of Texas denied Petitioners equal protection of the law under the Fifth and Fourteenth Amendments to the United States Constitution when they refused to apply Rule 505 of the Texas Rules of Civil Procedure and have remanded the case for a new trial.

4. That Article 6626 of the Texas Civil Statutes which pro-

hibits unacknowledged instruments from being recorded in the deed records of Texas denies the Petitioners who purchased their land with unacknowledged contracts of sale due process and equal protection of the law under the Fifth and Fourteenth Amendments to the United States Constitution.

STATUTES INVOLVED

Article 6626, Texas Civil Statutes (Appendix, Page A-14) and Rule 505, Texas Rules of Civil Procedure (Appendix, Page A-14).

STATEMENT

This case brought by the Petitioners as a class action involves the refusal by the Texas Supreme Court to enforce ecological land use restricitve covenants which had been enforced by the trial court and the Texas Court of Civil Appeals at Waco, Texas, which restrictions had been imposed on a 371.2 acre tract in Ellis County, Texas, by the developers of a housing subdivision known as Grande Casa Ranchitos, and released by these same developers on the Respondents' tract alone after the sale of several tracts to purchasers under unacknowledged and therefore unrecorded contracts of sale. In an unincorporated area in Texas, as in many other places in the United States, the primary protection landowners who buy recently developed raw acreage have that they will not lose their investment are the building and land use restrictive covenants that the developers imposed on the land to enable them to sell the land at enhanced values, this being recognized by Texas law in *Bethea v. Lockhart,* (Tex. Civ. App. 1939) 127 S.W. 2d 1029, Writ of Error Refused. In an incorporated area the legislative bodies of cities

and incorporated villages are given the protection of zoning powers, Vernon's Ann. Civ. St. art. 1101a. However, in Texas a minimum of 200 inhabitants are necessary to incorporate, Vernon's Ann. Civ. St. arts. 1133 et seq., and any group that has less than this has no such protection, thus leaving a number of people with no adequate safeguards to insure that a certain minimum standard of construction and land use will be met, other than the restrictive covenants they relied upon at the time they purchased. Realizing the inequities of this situation, there have been various attempts, both federal and state, to provide for land use control (e.g. the Texas Legislature recently had before it House Bill No. 105, which would have given the County Commissioner's Court zoning power outside of incorporated cities and towns, but the vested interest lobby got together and defeated this bill). The growth of the sale of rural land has been thriving. Sales have gone from an estimated $500 million in 1963, to $6 billion at the present (Dallas Morning News, Business Section, August 20, 1973, Page 7B). The problems arising from these sales caused the United States Congress to pass the Interstate Land Sales Full Disclosure Act and provided for the creation of an Office of Interstate Land Sales under the Housing and Urban Development Department, 15 U.S.C. § 1401 et seq. Unfortunately, this Act only protects against *interstate* land sales and was passed too late to effect the facts in the present case. The way that most sales at developments like the one in our case are made by contracts for sale or Contracts for Deed as they are sometimes called. These contracts are very one-sided and definitely favor the seller, providing for such things as acceleration clauses, the withholding of the deed until all payments which may take several

years, have been made, and so forth (see Contracts for Deed, Record 2, Plaintiffs' Exhibits 4, 5, 6). These contracts are not acknowledged, that is, they are not signed before an officer authorized to take such acknowledgment, the person who executes the instrument stating to such officer, the words generally being incorporated into the instrument, that he "had executed the same for the consideration and purposes therein stated" and the officer then signing and sealing same, Vernon's Ann. Civ. art. 6603, (Record 2, Plaintiffs' Exhibits 4, 5, 6, showing no provision for same). Since they are not acknowledged, they cannot, under Texas law, be recorded in the deed records, Vernon's Ann. Civ. St. art. 6626, and for this reason, such instruments are greatly favored by real estate developers who are financing the land sale themselves, since no foreclosure proceedings are necessary as would be the case with a Warranty Deed with a vendor's lien secured by a Deed of Trust, all of which would be recorded there being provisions for same. The procedure in Contracts for Deed in the instant case merely requiring the seller to give written notice that the entire balance on the installments is due within ten days of notice (the seller exercising his acceleration clause), the purchaser having previously agreed under the terms of the contract that all previous payments may be retained by the seller as liquidated damages (see Contracts for Deed, Record 2, Plaintiffs' Exhibits 4, 5, 6). Hence the developer can go around selling the same lot several times each time retaining the installments paid as liquidated damages and the deed records would reflect none of this, the legal title, usually in the form of a Warranty Deed with vendor's lien and secured by a Deed of Trust, still being in the seller as far as the deed records are concerned. These official looking

documents, the Contracts for Deed, give even the most wary of purchasers a false sense of security.

The facts in our case are that on February 28, 1968, the developers of Grande Casa Ranchitos, Tom and Jane Sewell, Ben D. Atwell II, and A. M. Byram placed restrictive covenants on the land then owned by them. Between May 11 and June 23, 1968, the owners of this land sold seven lots by contracts of sale or deed, three of which were admitted into evidence, these being to the Sitzes, McFadins and Selfs (Record 1, Page 83, Record 2, Plaintiffs' Exhibits 4, 5, 6). Now these contracts were unrecordable as per Texas law previously cited, since they were unacknowledged. Since these contracts could not be recorded they were not in fact recorded. On June 28, 1968, the same developers without the joinder of these three property owners executed a release of restrictive covenants on what subsequently became the Respondents' tract. But after the release and before the Respondents bought the property, Tom and Jane Sewell, two of the developers, purchased the property for themselves on November 25, 1968, by a properly recorded deed, and then on September 23, 1969, sold their tract to Respondent Wayne O. Glick, also by a properly recorded deed. Of course, in the mean time a number of people at the development had taken their property by deeds. Subsequently to the release but before the Respondents' purchase, the developers realized that they had improperly released the restrictions on the lot in question, therefore, Tom and Jane Sewell, recorded in the deed records an affidavit, a copy of which appears in the Record herein (Record 1, Page 83). This instrument stated that at the time of the release of the restrictions on the lot in question, that seven contracts for sale had been executed on seven lots that

had been sold, that these contracts for sale were unrecorded, and stated falsely that even though it was not necessary for this to be done the developers had gotten the consent of these seven lands owners to the release of restrictions, and then went on to identify the lots by the owners name, lot number, and the amount of acreage purchased. The affidavit also identified the purported release of restrictions by referring to its date of execution, date of filing and volume and page number where same could be found. At the time of trial, this affidavit was marked as Plaintiffs' Exhibit No. 8 (Record 2). The next morning after the trial had ended, and after the jury had been dismissed, but before Counsel for Petitioners had arrived in Court, and before Counsel for either party had argued the case to the trial court, Counsel for the Respondents, Ben D. Sudderth, in what would appear to be an attempt to destroy an exhibit that had been offered and admitted into evidence, same being an exhibit of opposing Counsel, without opposing Counsel's permission or approval, stuck paper all over Plaintiffs' Exhibit No. 8 with scotch tape so that same could not be removed without damaging the exhibit, so that the exhibit now appears as it does in this Record (Record 2, Page 70, Record 3, Page 28). The case which had been tried on the theory of Petitioners' co-Counsel, Tom Crum, was argued by him (Record 3). The action of Mr. Sudderth with regards to the mutilated exhibit was brought to the attention of the Texas Supreme Court and ignored by them, they apparently approving this conduct sub-silencio (Record 9, Page 28, Record 21, Page 20), the Texas Supreme Court prefering to play the "see no evil, hear no evil, say no evil" game whereby they state in their opinion "Plaintiffs relied upon the one sentence of the affidavit, but it was not proof

either of constructive or actual notice to defendants. The sentence does not locate any land by survey, subdivision or county. It does not disclose the author of the affidavit. There is no other proof that the defendants possessed actual notice of the contracts for deed." However, the Court of Civil Appeals had held in their decision that "Had this entire instrument been introduced in evidence (a copy of the entire instrument appears in the transcript) it would have established defendant had constructive notice of the contracts of sale," 484 S.W. 2d 594, 595, thus recognizing the truth of the matter which the Texas Supreme Court refused to recognize, the Court of Civil Appeals following the proper course since this was a case in equity and not in law. As a recent Texas decision, *Crain v. Firemen's & Policemen's Civil Service Com'n.*, (Tex. Civ. App. 1973) 495 S.W. 2d 20, stated in discussing the equitable remedy of an injunction, which is what is involved in our case, at 495 S.W. 2d 24:

> [7] On the merits of the petition for writ of injunction it is noticed in 4 Pomeroy's Equity Jurisprudence, 5th Ed., p. 935, "Injunctions in General", Sec. 1338, "Fundamental Principle" it is stated, as follows: "The general principle may be stated as follows: Wherever a right exists or is created by contract, by the ownership of property or otherwise, cognizable by law, *a violation of that right will be prohibited,* unless there are other considerations of policy or expediency which forbid a resort to this prohibitive remedy. *The restraining power of equity extends, therefore, through the whole range of rights and duties which are recognized by the law, and would be applied to every case of intended violation, were it not for certain reasons of expediency and policy which control and limit its exercise* * * *"
>
> [8] In Section 1339, "Generally" succeeding that from

> which Pomeroy's language is quoted, it is furthermore stated, as follows:" * * * Since the estate, interest, or claim of the complainant is purely equitable, it is exclusively cognizable by equity; and if its existence is shown, a court of equity not only has the jurisdiction but is bound to grant every kind of remedy necessary to its complete establishment, protection, and enforcement, according to its essential nature * * *"

Our case involved a permanent injunction which the Texas Texas Supreme Court dissolved. Our case involved the equitable enforcement of equitable restrictive covenants, and was purely a question of equity, not law. Our case involved the rights of equitable title holders, those who purchased under contracts for sale or deed which were unrecordable under Texas law. The release of restrictive covenants, relied upon by Respondents, and the only document that gave them any authority to violate the restrictive covenants applicable to all the other tracts, specifically states that the developers were all the owners of record (see Record 1, Page 81) thus placing a prudent man on inquiry so as to ascertain the existence of non-record equitable owners, such as such an inquiry would have revealed in our case, *Gulf Production Co. v. Conitnental Oil Co.,* (Tex. Sup. Ct. 1939) 132 S.W. 2d 553, 568. Judge Pope's citation to Clark's book, is misplaced. A reading of this work, Clark, Real Covenants and Other Interests Which "Run With Land" (1947), shows that only one chapter is applicable to our case and that is Chapter VI. Now in this chapter, Clark never states what Judge Pope has imputed to him, namely, the proposition that "The defendants say that they purchased their eight acre lot for value and they took without notice of the non-joinder of the equitable owners," this proposition being a creation of the fertile mind of

Judge Pope, who, after stating the proposition almost says, sic probo, or thus I prove it, and then he cites Clark, an authority never raised by the Respondents, their proposition of law, before Judge Pope got a hold of it being that they were bona fide purchasers as a matter of law (Record 17, Page 3). Clark never talks about contracts for sale and their effect on restrictive covenants, or the notice requirement as to equitable titles versus legal title, these are strictly creations of the Texas Supreme Court, as far as their being applicable to a restrictive covenant situation. The Texas Supreme Court went on to hold that the burden to prove Respondents were not good faith purchasers (a matter entirely within Respondents' knowledge) was on the Petitioners and that the Petitioners had failed to discharge their burden. In other words, Petitioners had the burden to prove the negative of a matter entirely within another person's knowledge, that is, notice. The Texas Supreme Court in placing this impossible burden of proof upon Petitioners admitted in their opinion by stating "The general rule in Texas, *in other areas of the law,* * * *" that this doctrine had never previously been applied to the instant type of case. Yet, the Texas Supreme Court then went on to deny the Petitioners the chance to discharge this burden by rendering judgment for Respondents on this hitherto inapplicable law! An incredible ruling to say the least that surely violates due process of law and equal protection of the law under the U.S. Constitution.

During the trial of the case, the Respondent who had handled the actual transaction that culminated in the conveyance of the tract, Freddie Glick, was cross-examined and testified as follows:

Q. And so you would be aware of all the documents that were on file then that pertained to your particular tract of land; is that correct?

A. I am, I might should be.

Q. Do I take it your answer is yes?

A. Yes. (Record 2, Page 63).

Previously, Respondent Wayne O. Glick, the husband of Freddie Glick, the father of Wynnette Amason and the father in law of W. D. Amason, and the person in whose name the legal title was, had testified that an attorney by the name of Dick Chapman had acted as their agent when he checked the Deed Records of Ellis County, Texas (Record 2, Pages 56, 57). Respondent Freddie Glick later testified that the said Dick Chapman had reported to her all the documents that he found or that pertained to her tract (Record 2, Pages 62, 63). Petitioners showed that amongst these documents was the affidavit found in the Record 1 at Page 83. Certainly, this should have established that the Respondents had notice of the unrecordable contracts for deed. All during this portion of the trial, Ben D. Sudderth, Counsel for the Respondents, was continuously interrupting cross-examination and coaching his clients when they made declarations against their interests (Record 2, Pages 56-70). Wayne O. Glick had previously testified that he assumed people were buying land in the area when he bought at the development (Record 2, Page 53). This raises the question as to whether the Texas Supreme Court applied the right rule of law in deciding burden of proof rather than whether Glick acted as a prudent man to ascertain the equitable owners as he was required to do by *Gulf Production Company*, supra.

In their opinion, the Texas Supreme Court makes the statement, unsupported by any evidence of any sort, that "The Glick's daughter, Mrs. Amason, and her husband, were living in the mobile home at the time of trial." This is a completely false statement and wholly untrue. This is a total fabrication, totally unsupported by any evidence, the untruth of which Petitioner Woodman is well aware by virtue of the proximity of his home to the mobile home (100 feet according Wayne O. Glick, Record 2, Page 51). Petitioners pointed out this glaring error in their Motion for Rehearing but the Texas Supreme Court refused to change it, even though eliminating this untruth would not have effected the substantive portion of their opinion and ruling (Record 24, Pages 22-24). Petitioners raise this matter before this Honorable Court to show the slipshod and arbitrary fashion in which the Texas Supreme Court disposed of this case, and this is said with all due respect to the Texas Supreme Court. Thus, for all time, unless corrected by the United States Supreme Court, this untruth will become a permanent part of the case history of this Country, for all future generations to rely upon.

REASONS FOR GRANTING THE WRIT

1. The United States Supreme Court has consistently held that the bona fide purchase or innocent purchaser for value without notice defense is an affirmative defense and the burden of proof to prove this defense is upon the party relying upon the defense particularly so when the defense requires, as in the instant case, testimony peculiarly within the knowledge of the party relying upon the defense.

As this Court held in *Armstrong v. Ashley*, 204 U. S. 272, 27 S. Ct. 270, 51 L. ed. 482:

> "The owner of real estate is under no obligation to watch the records to see whether some one who does not own his property has assumed to * * * convey it by deed to some third party."

In *Smith v. Orton*, 21 How 241, 16 L. ed. 104, this Court stated:

> "Knab held the naked legal title with undoubted right in Hubbard to call for its surrender and his assignee stands on the same footing 4 Kent's Com. 157"

The evidence in our case and the ruling of the Texas Supreme Court shows that the developers who only held the naked legal title and had already departed with several equitable titles by contracts for deed, illegally and improperly released the restrictive covenants on the Respondents' tract by not having the joinder of the equitable owners in releasing same. The question then became, according to the Texas Supreme Court, on whom was the burden to prove that the Respondents had notice of the equitable owners who had failed to ratify the release of restrictive covenants. The Respondents had defended the invalid release of restrictive covenants on the grounds that they were not bound by the lack of the joinder of the equitable owners because they had no notice of their equities, that is, they were bona fide purchasers. To establish this defense, three elements are necessary, (1) the person so claiming acted in good faith, (2) he paid valuable consideration, and (3) he had no notice of the defect or of others rights in the same matter, *Forister v. Coleman*, (Tex. Civ. App. 1967) 418 S.W. 2d 550, Writ Ref., 431 S.W. 2d 2; Ibid, *U. S. v. California &*

O. Land Co., 148 U. S. 31, 13 S. Ct. 458, 37 L. Ed. 354. Generally this is an affirmative defense, *Valley Ready-Mix Concrete v. Valley State Bank*, (Tex. Civ. App. 1950) 227 S.W. 2d 231. The Texas Supreme Court realized the deficiency of this defense so they twisted it around to suit a better and more clear-cut ruling on their part and rephrased the question to read that Respondents "purchased their eight-acre lot for value and they took without notice of the non-joinder of the equitable owners" thus being able to *squeeze* the case into the hitherto inapplicable Texas cases that say that "the one who relies upon an equitable title to land as against a subsequent owner of the legal title assumes the burden of showing that the latter is not an innocent purchaser for value and without notice," thus being able to dispense with the necessity of good faith which would have been required under the bona fide purchaser defense. But the U. S. Supreme Court has held otherwise in similar cases involving affirmative allegations such as this, including the bona fide purchase defense, see *Ochoa v. Hernandez y Morales*, 230 U. S. 139, 33 S. Ct. 1033, 57 L. ed. 1427; *Onraha Hotel Co. v. Wade*, 97 U. S. 13, 24 L. ed. 917; *U. S. v. Linn*, 1 How 104, 11 L. ed. 64; *Great Northern R. Co. v. Hower*, 236 U. S. 702, 35 S. Ct. 465, 59 L. ed. 798; *Moelle v. Sherwood*, 148 U. S. 21, 13 S. Ct. 426, 37 L. ed. 350. It is clear under these rulings and under the ruling of *Smith v. Orton*, supra, that not only was the burden on the Respondents, but the Respondents, as assignees of the developers, stood on the same footing as the developers in having notice, otherwise the owners of property under unrecordable contracts for deed would always have to be watching the records to see whether or not the developers may sell their land or remove the restrictions

without their consent. After the release had been accomplished, the developers turned around and conveyed the lot in question to two of their numbers, namely, Tom and Jane Sewell, who thereafter sold it to Respondent Wayne O. Glick. As this Court stated in *Warner v. Morton*, 20 How 448, 15 L. Ed. 950:

> "If the vendor remains in possession, it is ordinarily a badge of fraud, and requires explanation."

And the fraud here of not getting the joinder of the equitable owners in releasing the restrictions is abundantly clear. The U. S. Supreme Court has further stated in *Selma, R. & D. R. Co. v. U. S.*, 139 U. S. 650, 11 S. Ct. 638, 35 L. ed. 266, that:

> "The burden of proof lies on the person who wishes to support his case by a particular fact which lies more peculiarly within his knowledge, or of which he is supposed to be cognizant."

Good faith, valuable consideration, absence of notice, are all matters peculiarly within the knowledge of the person relying upon them, in our case, the Respondents. Also see *U. S. v. Denver & R. G. R. Co.*, 191 U. S. 84, 24 S. Ct. 33, 48 L. ed. 106. As to notice the Petitioners submit the following authorities:

Angle v. Northwestern L. Ins. Co., 92 U. S. 330, 23 L. ed. 556;

Brush v. Ware, 15 Pet 93, 10 L. ed. 672;

Simmons Creek Coal Co. v. Doran, 142 U. S. 417, 12 S. Ct. 239, 35 L. ed. 1063, which holds at 35 L. ed. 1072, as follows:

> "He [the purchaser] must look to the title papers under which he buys, and is charged with notice of all the facts appearing upon their face, or to the knowledge of which anything there appearing will conduct him. He has no right to shut his eyes or his ears to the inlet of information, and then say he is a bona fide purchaser without notice."

Joy v. St. Louis, 138 U. S. 1, 11 S. Ct. 243, 34 L. ed. 843, (which deals with covenants running with the land).

The Respondents testified that their attorney checked the deed records, and that he told them of all the documents to be found therein that pertained to their tract. Notice to an attorney is to notice to his client, see the following:

> *Hexter v. Pratt,* (Tex. Com. of App. 1928) 10 S.W. 2d 692;
>
> *May v. LeClaire,* 11 Wall 217, 20 L. ed. 50;
>
> *Rogers v. Palmer,* 102 U. S. 263, 26 L. ed. 164;
>
> *Link v. Wabash R. Co.,* 370 U. S. 626, 82 S. Ct. 1386, 8 L. ed. 2d 734.

The U. S. Supreme Court has stated in *Castle v. Bullard,* 23 How 172, 16 L. ed. 424, that:

> "To establish fraud, it is not necessary to prove it by direct and positive evidence. Circumstantial evidence is sufficient, and, in most cases, is the only proof that can be adduced."

The fraud of the developers in releasing restrictions after the sale of unrecordable contracts for deed is clear in the Record of this case. Also see *Wecker v. National Enameling & Stamping Co.,* 204 U.S. 176, 27 S. Ct. 184, 51 L. ed. 436.

As to restrictive covenants, Petitioners submit the case of *Chapman v. Sheridan-Wyoming Coal Co.,* 338 U. S. 621, 70 S. Ct. 392, 94 L. Ed. 393, which states:

> "Equitable restrictions as to the use or disposition of land are real estate, part and parcel of the land to which they attached, and pass by conveyance."

Petitioners submit that under this doctrine, once the equitable

restrictions have attached they cannot be removed unless properly removed by the concurrence of all landowners, and the improper removal of same, as in our case, causes the purchaser to receive from his seller no greater interest in same than what the seller had, which in this case would be a purported release that was a nullity, and thus the restrictions pass intact to the Respondents, otherwise Respondents would be allowed to obtain a *greater* interest than what they bought by virtue of their purported lack of notice of the equitable rights of others, as the Texas Supreme Court would have it.

The U. S. Supreme Court has consistently held that in a sales contract of real estate where the record title remains in the vendor, the vendor is a trustee of the legal title for the vendee to the extent of his payment and the vendor cannot do anything to violate this trust, e.g. *Jennison v. Leonard,* 21 Wall 302, 22 L. Ed. 539; *Bissell v. Heyward,* 96 U. S. 580, 24 L. Ed. 678; *Gunton v. Carroll,* 101 U. S. 426, 5 L. Ed. 985. Yet the Texas Supreme Court would allow a violation of this trust to benefit a wrongdoer who purchases from such trustee, as under the facts of our case.

Pomeroy in his work entitled, A Treatise on Equity Jurisprudence, Vo. III, (Bancroft-Whitney Company, San Francisco, the Lawyers Co-Operative Publishing Company, Rochester, N. Y., 1941) by John Norton Pomeroy, states in Sec. 735, as follows:

> "In the United States these elementary notions seem to have been sometimes overlooked, and the courts sometimes seem to have extended the doctrine of *bona fide* purchase farther than the acknowledged principles of equity would warrant. The tendency is marked and strong in the

> courts of many states, even when acting as tribunals of law, to make the doctrine a legal *rule of property*, and to apply it alike to persons who have acquired either a legal or an equitable title to chattels and things in action, as well as to those who have acquired any legal or equitable interest in land. A *subsequent* holder, even for a valuable consideration and without notice, has certainly no higher right than a prior holder equally innocent and with an equally meritorious ownership. American courts seem sometimes to have acted upon exactly the opposite notion, and to have assumed that a *subsequent* title was necessarily the better one."

The question in our case was purely one of equity and not of law. It was not as the Texas Supreme Court erroneously interpreted the case to be of equitable title versus legal title but rather the enforcement of equitable rights or the non-enforcement of equitable rights because of a purported release of these equitable rights and on whom should the burden fall to prove the property is unrestricted, on the person seeking to enforce the restrictions, or on the person seeking to defeat the restrictions. Petitioners humbly submit that it is on the latter. Since the issue was one solely of equity the Texas Supreme Court denied the Petitioners due process and equal protection of the law in applying law doctrines to their case, and should have resolved the case solely on equity.

2. That the action of the Texas Supreme Court in failing to remand the instant case for a new trial after having reversed the case on the basis of hitherto inapplicable law denied Petitioners due process of law and equal protection of the law under the Fifth and Fourteenth Amendments to the United States Constitution.

The authorities cited by the Texas Supreme Court in support

of their proposition that the burden of proof was upon the Petitioners in this case since they relied upon equitable titles as against the Respondents' so called "legal" title had never previously been applied in Texas to a restrictive covenant situation, and this is by the Texas Supreme Court's own admission, wherein they state in the instant opinion, "The general rule in Texas, *in other areas of the law,* * * *). As a matter of fact this rule has never been previously applied in a case like the instant one in any other jurisdiction anywhere in the world, and in their Motion for Rehearing the Petitioners challenged the Texas Supreme Court to come forth with just one other citation that ruled similarly to them on this question of restrictive covenants, and of course, they were unable to do so, there being no such authorities (Record 24, Page 26). Thus, it is clear that in rendering judgment for the Respondents, rather than remanding for a new trial, after having reversed the case on the basis of hitherto inapplicable law, by their own admission, the Texas Supreme Court was attempting to deny Petitioners their right to prove their case by discharging this new burden that the Texas Supreme Court had placed upon them. In effect what the Texas Supreme Court did was to change the rules and then rule against the Petitioners for not having followed this change in the rules from the first place, certainly a questionable procedure, especially when the general rule in Texas itself is that a Court should generally remand for a new trial after reversal, *Patrick v. Webb,* (Tex. Civ. App. 1963) 369 S.W. 2d 446, 449, Ref., n.r.e.; *Barnum v. Lopez,* (Tex. Sup. Ct. 1971) 471 S.W. 2d 567. This denial of the Texas Supreme Court of a new trial in this case was merely part of a continuous attempt on their part to impose their reactionary philosophy of the free

use of land as exemplified by every decision of the Court over the last few years involving restrictive covenants wherein they have consistently struck the covenants down. See *Smith v. Williams,* (Tex. Sup. Ct. 1967) 422 S.W. 2d 168, (an opinion by Assoc. Jus. Walker, the man with the greatest tenure on the Texas Supreme Court at the present time); *MacDonald v. Painter,* (Tex. Sup. Ct. 1969) 441 S.W. 2d 179, (an opinion by Assoc. Jus. Pope, the author of the opinion in the instant case, also a man with great tenure on the Texas Supreme Court, wherein he reverses the Court of Civil Appeals which had reversed then District Court Judge and now Assoc. Jus. Reavley of the Tex. Sup. Ct., who had ruled against the restrictions); *Burns v. Woods,* (Tex. Sup. Ct. 1973) 492 S.W. 2d 940, (an opinion by Assoc. Jus. Steakley, the man with the next highest tenure Walker as an Assoc. Jus.); *Amason v. Woodman,* (Tex. Sup. Ct. 1973) ..... S.W. 2d ..... (another opinion by Assoc. Jus. Pope). Rule 505, Texas Rules of Civil Procedure requires the Texas Supreme Court to remand a case for a new trial in the interest of justice. Surely in the interest of justice when new law has been applied to a fact situation not previously bound by such law a new trial should be ordered. The failure of the Texas Supreme Court to apply Rule 505 to the instant case is a blatant denial of the Petitioners' rights to due process of law and equal protection of the law under the Fifth and Fourteenth Amendments to the United States Constitution.

3. That Art. 6626, Texas Civil Statutes, which requires that instruments be acknowledged before they can be recorded in the deed records denies all purchasers under instruments that are not acknowledged such as contracts for deed and other equitable titles due process of law and equal protection of law

under the Fifth and Fourteenth Amendments to the United States Constitution.

The contracts involved in the present case cannot, under Texas law, be recorded. (See Art. 6626, Appendix). Since they cannot be recorded they cannot be used to give notice, both actual and constructive depending on whether one actually checks the deed records or whether by the mere recording of the instrument notice is given (if it falls in one's chain of title) as the purpose of the deed records is to give notice to the public of the status of land as to title, restrictions, encumbrances, easements, etc. Hence no notice by virtue of the deed records in Texas can be given by those who hold under contracts for deed. The Fifth Amendment to the U. S. Constitution provides:

> "* * * nor [shall any person] be deprived of life, liberty or property, without due process of law * * *"

The Fourteenth Amendment provides:

> "* * * nor shall any State deprive any person of life, liberty or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws."

In *Barbier v. Connolly*, 113 U. S. 27, 5 S. Ct. 357, 28 L. Ed. 923, this Court said:

> "* * * that equal protection and security should be given to all under like circumstances * * * that no greater burden should be laid upon one than are laid upon others in the same calling and conditions * * *"

The owners of equitable title have all the rights to possession, to ownership, to use of the land, and all other rights as the owner of legal title, the only difference in their ownership being that one owns by virtue of an unrecordable contract and the other

by virtue of a recordable deed. Thus the one who has a deed is given a slightly greater edge, that is, he can record his instrument in the deed records and thus give public notice. If the equitable owner tries to record his instrument he may open himself up to a suit for damages for clouding the legal title of the holder of the deed. It is because of this great inequity that Courts talk of the holder of legal title who has sold his land to someone by a contract as holding the mere "naked" legal title, *Smith v. Orton,* supra. The Texas Supreme Court, even with the knowledge that same could not be recorded and thus give notice to the public, still put the burden of proof upon the holders of the equitable title to show that the holder of the legal title had notice of the equitable owner's interest, and thus gave the holder of legal title greater rights than the holder of equitable title, who, through no fault of his own, but because of Art. 6626, cannot record his document, and this surely gives one upon the same calling and condition greater rights as both are landowners, the only difference in their ownership is in the documentation, one having a contract and the other a deed; but isn't a deed really a form of contract anyway? And doesn't this greater right in one over the other deny the one not chosen equal protection and due process of law? Shouldn't all have equal access to the public records so that all can give notice? Or, if one party such as the holder of legal title has access to the deed records for purposes of recording and if the other party such as the holder of equitable title does not, shouldn't the one who has access to the public records, that is, the holder of legal title be called upon to carry the burden of proof if he claims that he is a bona fide purchaser or an innocent purchaser without notice? Just because his instrument

has been recorded and the other person's could not why should the former be given greater rights as to burden of proof?

IMPORTANCE

The questions presented here are of vital importance to the Petitioners as individuals because their very homes are at stake, to housing developments and land sales everywhere and to the several states. The opinion of the Texas Supreme Court follows no concrete precedents, and their action in refusing to remand this case for a new trial after reversing the lower courts on the basis of hitherto inapplicable law obviously violates the due process and equal protection of the law provisions of the Fifth and Fourteenth Amendments to the United States Constitution.

CONCLUSION

For these reasons, a writ of certiorari should issue to review the judgment and opinion of the Texas Supreme Court, and after such review the decision of the trial court and of the Court of Civil Appeals at Waco, Texas, should be affirmed and the decision of the Texas Supreme Court reversed, or alternatively, the decision of the Texas Supreme Court should be reversed and the case remanded for a new trial.

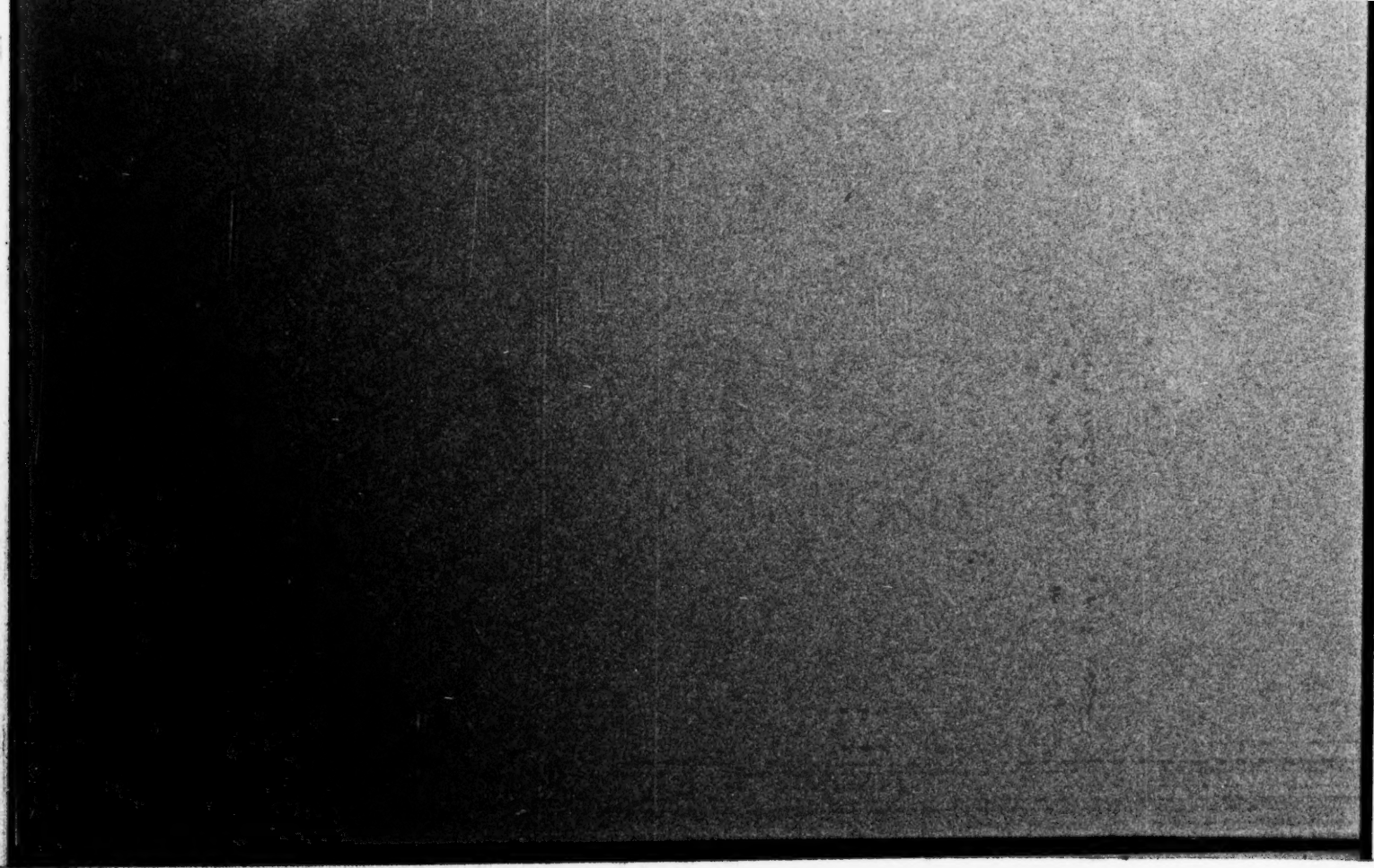
Respectfully submitted,

WALTER J. WOODMAN,
507 Water Street,
Waxahachie, Texas 75165,
Counsel for Petitioners.

CERTIFICATE OF SERVICE

I hereby certify that on this the 14th day of September, 1973, three copies of the Petition for Writ of Certiorari were mailed, postage prepaid, to Ben D. Sudderth, Exq., 109 W. Grand, Comanche, Texas 76442, Counsel for Respondents. I further hereby certify that all parties required to be served have been served.

Walter J. Woodman



Affirmed 10 August, 1972

No. 5170

In the

COURT OF CIVIL APPEALS

FOR THE
TENTH SUPREME JUDICIAL DISTRICT OF TEXAS
AT WACO

W. D. AMASON, et ux, et al.,

Appellants,

v.

WALTER J. WOODMAN, et al.,

Appellees.

From 40th Judicial District
Court Ellis County, Texas

OPINION

This is an appeal by defendants Amason, et al, from judgment decreeing land owned by them, subject to restrictive covenants; and ordering defendants to remove a mobile home from their property.

Plaintiffs Woodman, et al, brought this suit to enforce restrictive covenants prohibiting trailer houses on real property owned by defendants Amason, et al. Trial was to the court which rendered judgment decreeing the defendants' land subject to such restrictive covenants; that a release of the land from such covenants was invalid; permanently enjoining defendants

from violating the restrictions, and ordering defendants to remove a mobile home from their property.

Defendants appeal on 2 points, contending "the evidence established as a matter of law that defendants were bona fide purchasers for value without notice".

Restrictive covenants were placed on Grande Casa Ranchitos No. 2, comprising 371.249 acres, by the owners Tom Sewel, Jane Sewell, Ben Atwell, and A. M. Bryan on February 15, 1968, and recorded in the Deed Records of Ellis County. Such restrictions prohibited "* * * house trailers * * * unless enclosed in a building or out of sight behind a screening fence at least 6 feet high and constructed of materials that cannot be seen through". Thereafter on June 28, 1968, Tom Sewell, Jane Sewell, Ben Atwell, and A. M. Bryan executed "a Release of Restricting Covenants", releasing from the restrictive covenants executed on February 15, 1968, the 8.34 acre tract, now owned by defendants. Such release was recorded in the Deed Records of Ellis County on July 16, 1968. The two Sewells, Atwell and Bryan were the only owners of record of Grande Casa Ranchitos No. 2 on the date of the execution of the release of the 8.34 acre tract.

Defendants purchased the 8.34 acres on September 23, 1969 for a valuable consideration.

After February 15, 1968, and before June 28, 1968, the owners of Grande Casa Ranchitos made contracts to sell lots in the subdivision to Donnie L. Self and wife; Albert Terry Sitz and wife; and Henry Truman McFadin and wife, which were never recorded in the Deed Records of Ellis County, but which contracts are in evidence in this case.

Defendants testified they had no knowledge of any contracts to purchase any tracts in the subdivision which may have been outstanding on the date of the release of the restrictive covenants, and further that they had a lawyer to check the deed records of Ellis County for records that might pertain to the tract they purchased.

There is in evidence that an instrument was duly filed and recorded in the Deeds Records of Ellis County on December 2, 1968, which recites "* * * the only tracts sold under contract of sale were to * * * Henry Truman McFaddin and wife * * * Albert Terry Sitz and wife * * * Paul C. Vandiver and wife * * * Sammie Ray Dowell and wife * * * Donnie L. Self and wife * * * Billy R. Jones and wife * * *"[1]

Those with contracts to purchase tracts in the subdivision were beneficial owners with equitable title. *Leeson v. City of Houston*, S. Ct. 243 S.W. 485, 489; and some of the owners of property in a restricted subdivision may not release such restrictions without the concurrence of the others who own property in the subdivision. *Smith v. Williams*, S. Ct. 422 S.W. 2d 168.

Thus since those with contracts to purchase lots in the subdivision did not join in the June 28, 1968, release, it is ineffective to release the 8.34 acres from the restrictive covenants, if a purchaser had either constructive or actual notice of same.

But since the contracts of sale were not of record, defendants did not have constructive notice that such release was ineffective.

[1] Had this entire instrument been introduced in evidence (a copy of the entire instrument appears in the transcript) it would have established defendant had constructive notice of the contracts of sale. Smith v. Bowers, CCA (NWH) 463 S.W. 2d 222.

Defendants assert that they were bona fide purchasers without actual notice as a matter of law. The only evidence that defendants had no knowledge of the outstanding contracts of sale was the defendants' own testimony. There is in evidence the contracts of sale of lots in the subdivision to Self, Sitz and McFadin, made prior to the release of the restrictions, and the excerpt from the instrument recorded in the Deed Records of Ellis County, recorded before defendants purchased the 8.34 acre tract, reflecting contracts of sale to Self, Sitz and McFaddin.

Defendants were interested witnesses. The trial judge had the right to pass on the credibility of such witnesses and the weight to be given their testimony. *Simmonds v. St. Louis, B & M Ry.*, S. Ct. 91 S.W. 2d 332. *Cochran v. Wool Growers Central Storage Co.*, 166 S.W. 2d 904. We think under the record he was authorized to believe that defendants did not carry their burden to establish that they had no actual notice.

All defendants' points have been considered and are overruled.

AFFIRMED

/s/ FRANK G. MCDONALD

Chief Justice

In the

SUPREME COURT OF TEXAS

FROM ELLIS COUNTY, TENTH DISTRICT

No. B-3655

W. D. AMASON, et al.,

Petitioners,

v.

WALTER J. WOODMAN, et al.,

Respondents.

Plaintiff, Walter J. Woodman, instituted this suit as a class action to enforce a restrictive covenant which prohibits mobile homes in a subdivision known as Grande Casa Ranchitos No. 2 in Ellis County. The trial court granted plaintiffs' prayer for injunction that defendants W. D. Amason and wife and Wayne O. Glick and wife permanently move their mobile home from their eight-acre lot. The court of civil appeals affirmed the judgment of trial court. 484 S.W. 2d 594. The only question presented is whether, as held by the court of civil appeals, the defendants had the burden to prove that they did not possess actual knowledge of certain unrecorded contracts of sale which were executed prior to a release of defendants' lot from the restrictive covenants by the original subdivision owners. We hold that the burden of proof was on the plaintiffs. We reverse the judgments of the courts below.

On February 28, 1968, Tom and Jane Sewell, Ben Atwell and A. M. Byram owned 371.2 acres of land in Ellis County. On that date they recorded a set of restrictive covenants on the

land, one of which prohibited the use of house trailers on the land. Between May 11 and June 23, 1968, the owners sold three lots by contracts for deed to the Sitzs, McFadins and Selfs. None of those contracts was recorded. On June 28, 1968, all of the original owners of the subdivision executed and recorded a release of the restrictions insofar as they affected the eight-acre lot which is here in question. Those persons holding under the unrecorded contracts for deed did not join in the release. Tom and Jane Sewell then purchased the released lot on November 25, 1968, and they recorded their deed. The Sewells sold their lot to Wayne Glick on September 23, 1969, and in December, 1971, he moved a mobile home onto the lot. The Glicks' daughter, Mrs. Amason and her husband, were living in the mobile home at the time of trial. Plaintiff Woodman obtained his deed to a seven-acre lot in the subdivision on May 6, 1971.

Plaintiffs' proof consisted of the recorded restrictive covenants which reached the original 371 acres of land, the subsequent deed from the original owners to Woodman of a seven-acre lot within the subdivision, the several unrecorded contracts for a deed, and the fact that the defendants had moved a mobile home onto their eight-acre lot which was within the original 371-acre subdivision. The defendants then proved the release of the original restrictive covenants as to their eight-acre lot and their deed which was executed after the release was recorded. They proved that they purchased their lot for $8,902.09 and assumed a lien in the sum of $13,597.91. They denied any knowledge of the unrecorded contracts and asserted their belief that their lot was released from the restrictions.

After the defense rested, plaintiffs offered in evidence, for impeachment purposes only, part of an affidavit which was recorded on December 2, 1968, in the Ellis County Clerk's office. The only part of the recorded affidavit which plaintiffs introduced is the one sentence:

> The only tracts sold under contracts of sale were as described by an unrecorded survey plat as Tract 1 of 4.718 acres sold to Henry Truman McFadin and wife, Mary Jane McFadin; Tracts No. 6 and 7 of 7.500 acres sold to Albert Gerry Sitz and wife, Ruby Nell Sitz; Tract No. 10 of 2.500 acres sold to Sammie Ray Dowell; Tract No. 29 of 3.178 acres sold to Danny L. Self and wife, Gloria J. Self; and Tract No. 30 of 4.317 acres sold to Billy R. Jones, and wife, Barbara Jones.

The plaintiffs rely upon the rule that a release of restrictive covenants is not effective unless all persons who own property in the restricted subdivision join in the release. *Smith v. Williams*, 422 S.W. 2d 168 (Tex. 1967); *Farmer v. Thompson*, 289 S.W. 2d 351 (Tex. Civ. App. 1956, writ ref'd n.r.e.). They assert that the release was ineffective, because there were three persons who held equitable title to lots in the subdivision who failed to join in the release upon which the defendants relied. The defendants say that they purchased their eight-acre lot for value and they took without notice of the non-joinder of the equitable owners. See CLARK, REAL COVENANTS AND OTHER INTERESTS WHICH "RUN WITH LAND" (1947).

Contrary to the holding of the court of civil appeals, the plaintiffs had the burden to prove that the defendants purchased their lot with actual or constructive notice that the owners of equitable title failed to join in the release. The general rule in Texas, in other areas of the law, is that the one who relies upon

an equitable title to land as against a subsequent owner of the legal title assumes the burden of showing that the latter is not an innocent purchaser for value without notice. *Teagarden v. R. B. Godley Lumber Co.*, 105 Tex. 616, 154 S.W. 973 (1913); *Gillian v. Day*, 179 S.W. 2d 575 (Tex. Civ. App. 1944, writ ref'd); *Ratcliffe v. Mahres*, 122 S.W. 2d 718, 723 (Tex. Civ. App. 1938, writ ref'd); Lange, 4 TEXAS PRACTICE, *Land Titles* § 465 (1961). This court in *Curlee v. Walker*, 112 Tex. 40, 244 S.W. 497 (1922), stated that the correct rule governing restrictive covenants is stated in *Hooper v. Lottman*, 171 S.W. 270 (Tex. Civ. App. 1914, no writ), wherein the court wrote in part:

> So the general rule may be safely stated to be that where there is a general plan or scheme adopted by the owner of a tract, for the development and improvement of the property by which it is divided into streets and lots, and which contemplates a restriction as to the uses to which lots may be put, or the character and location of improvement thereon * * * a purchaser and his assigns may enforce the covenant against any other purchaser, and his assigns, *if he has bought with actual or constructive knowledge of the scheme, and the covenant was part of the subject-matter of his purchase.* (Emphasis added.)

The plainitffs failed to prove that the defendants purchased their lot with either constructive or actual notice that there were some owners of equitable title to land within the subdivision who failed to join in the release of the restrictions. Plaintiffs relied upon the one sentence of the affidavit, but it was not proof either of constructive or actual notice to defendants. The sentence does not locate any lands by survey, subdivision or county. It does not disclose the author of the affidavit. There is no other proof that the defendants possessed actual notice

of the contracts for deed. We conclude that the plaintiffs failed to discharge their burden to prove that the defendants were not good faith purchasers of their lot.

The judgments of the courts below are reversed, and judgment is here rendered dissolving the permanent injunction.

Jack Pope

Associate Justice

OPINION DELIVERED:
May 2, 1973

A-10

SUPREME COURT OF TEXAS

FROM ELLIS COUNTY, TENTH DISTRICT

No. B-3655

May 2, 1973.

W. D. AMASON, et al.,

v.

WALTER J. WOODMAN, et al.,

"This cause came on to be heard on writ of error to the Court of Civil Appeals for the Tenth Supreme Judicial District and the original transcript and transcript showing the proceedings in the Court of Civil Appeals having been duly considered, because it is the opinion of the Court that there was error in the judgments of the District Court and Court of Civil Appeals, it is, therefore, *adjudged, ordered* and *decreed* that said judgments be, and hereby are, reversed and set aside.

"And this Court now proceeding to render judgment as should have been rendered below, it is *considered, adjudged, ordered* and *decreed* that the judgment be, and hereby is, rendered dissolving the permanent injunction.

"It is further ordered that respondents, Walter J. Woodman and wife, Mrs. Walter J. Woodman, Bob McNeely and wife, Mrs. Bob McNeely and Gerald Miller and wife, Mrs. Gerald Miller, pay all costs in this cause expended and incurred in this Court, Court of Civil Appeals and District Court; that petitioners, W. D. Amason, and wife, Mrs. W. D. Amason, and

Wayne O. Glick and wife, Freddie Glick, have and recover of and from respondents, (above named), the costs by them expended and incurred in said Courts, and that this decision be certified to the District Court of Ellis County, Texas, for observance."

SUPREME COURT OF TEXAS

FROM ELLIS COUNTY, TENTH DISTRICT

No. B-3655

June 13, 1973.

W. D. AMASON, et al.,

v.

WALTER J. WOODMAN, et al.,

Respondents' motion for rehearing, filed in the above numbered and entitled cause on May 16, 1973, having been duly considered, it is ordered that said motion be, and hereby is, overruled.

Rule 505. Decision

In each case, the Supreme Court shall either affirm the judgment, or reverse and render such judgment as the Court of Civil Appeals should have rendered, or reverse the judgment and remand the case to the lower court, if it shall appear that the justice of the case demands another trial, subject to the provisions of Rules 503 and 504 relating to reversals.

Art. 6626. [6823] [4639] [4331] What may be recorded

The following instruments of writing which shall have been acknowledged or proved according to law, are authorized to be recorded, viz.: all deeds, mortgages, conveyances, deeds of trust, bonds for title, covenants, defeasances or other instruments of writing concerning any lands or tenements, or goods and chattels, or moveable property of any description; provided, however, that in cases of subdivision or re-subdivision of real property no map or plat of any such subdivision or re-subdivision shall be filed or recorded unless and until the same has been authorized by the Commissioners Court of the county in which the real estate is situated by order duly entered in the minutes of said Court, except in cases of the partition or other subdivision through a court of record; provided that where the real estate is situated within the corporate limits or within five miles of the corporate limits of any incorporated city or town, the governing body thereof or the city planning commission, as the case may be, as provided in Article 974a, Vernon's Texas Civil Statutes, shall perform the duties hereinabove imposed upon the Commissioners Court.

Acts 1846, p. 236; P.D. 5004; G.L. vol. 2, p. 1542. Amended by Acts 1931, 42nd Leg., p. 371, ch. 217, § 1; Acts 1951, 52nd Leg., p. 745, ch. 403, § 1.

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IN THE

Supreme Court of the United States

Supreme Court, U. S.
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MICHAEL RODAK, JR., CLERK

October Term, 1973.

No. 73-469

HARRIET SIGNER,

Petitioner,

v.

TRUSTEES OF THE PROPERTY OF PENN CENTRAL TRANSPORTATION CO.,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

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INDEX.

	Page
JURISDICTION	2
QUESTIONS PRESENTED FOR REVIEW	3
STATEMENT OF THE CASE	4
REASONS FOR GRANTING THE WRIT	10
(1) Petitioner Appellant's Class Action in the District Court and in the Appeals Court Below, Specifically and Directly Raised the Fundamental and Important Constitutional Issue of the "Taking the Property of the Bondholders in Question of the Value in Excess of 100 Million Dollars (Up to May 1972) by the Respondents, During the Pendency of the Reorganization Proceedings and Their Continuing This Practice," Contrary to the Applicable Decisions of the Supreme Court and in Clear Violation of the Provision of the Fifth Amendment to the Constitution of the United States	10
(2) The Orders of the Courts Below (Appendix "A" and "B") Are Repugnant to the Due Process Clause of the Fifth Amendment to the Constitution	12
(3) This Reorganization Proceeding Effecting the Largest Railroad in the Country and the Unusual Number of Other Rail Lines Now Involved in Similar Proceedings Concerns an Important Economic Situation Effecting the Entire Nation	13
APPENDIX "A"—Opinion and Order No. 988	A1
APPENDIX "B"—Judgment Order	A6

TABLE OF CITATIONS.

Cases:	Page
Associated Co. v. Greenhut, 66 F. 2d 428 (3d Cir. 1933)	11
Bindeil v. Liberty Trust Co., 248 F. 112 (3d Cir. 1917)	11
Borg v. New York Majestic Corp., 139 N. Y. S. 2d 72 (1954)	13
Campbell v. Hudson & Manhattan R. R. Co., 102 N. Y. S. 2d 878 (1951)	13
Continental Illinois National Bank v. Chicago, Rock Island & P. Ry. Co., 294 U. S. 648	11
Farmer's Loan & Trust Co. v. Northern Pack. Co., 66 Fed. 169 (1895)	13
In re Franklin Garden Apartments, 124 F. 2d 451 (2d Cir. 1941)	11
In re Third Ave. Transit Corp., 198 F. 2d 703 (2d Cir. 1952)	11
Louisville Joint Stock Land Bank v. Radford, 295 U. S. 602	10
Rabinowitz v. Kaiser Frazer Corp., 111 N. Y. S. 2d 539 (1952)	13
Reconstruction Finance Corp. v. Kaplan, 185 F. 2d 791 (1st Cir. 1950)	11
Schechter v. U. S. of America, 295 U. S. 495	13
Wright v. Mountain Trust Bank, 300 U. S. 400	11

Statute:	
Bankruptcy Act:	
Section 77	4, 11
Section 77(c)(7)	5
Section 77(p)	5, 7

U. S. Constitution:	
Fifth Amendment	2, 3, 10, 11, 13

IN THE

Supreme Court of the United States

OCTOBER 1973 TERM.

No. .

HARRIET SIGNER,
Petitioner-Appellant,

v.

TRUSTEES OF THE PROPERTY OF PENN CENTRAL TRANSPORTATION CO.,
Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

Petitioner Harriet Signer respectfully prays for a writ of Certiorari to the United States Court of Appeals for The Third Circuit to review an order of that Court entered June 22, 1973 which affirmed the opinion and order No. 988 issued October 26, 1972 by the U. S. District for the Eastern District of Pennsylvania in charge of the reorganization proceedings of the Penn Central Transportation Co. Copies of both orders and opinions are hereto appended as (Appendix "A" and "B") and made part of this petition. These orders and opinions are unreported as of the date of this petition.

JURISDICTION.

The Jurisdiction of this Court is invoked on the grounds that petitioner's class action brought in the District Court below (Document 1975) and on the Appeal to the Court of Appeals for the Third Circuit, raises the grave and all important issue of respondents individually and as trustees of the debtor in reorganization, have collected and diverted rents and income generated from the non-rail, defaulted mortgaged properties of the value in excess of 100 million dollars, the property of petitioner and thousands of bondholders and continue such taking of property without due process of law, in clear violation of the Fifth Amendment to the United States Constitution which provides that "no person shall be deprived of life, liberty or property, without due process of law; nor shall property be taken for public use without just compensation."

QUESTIONS PRESENTED FOR REVIEW.

1. Whether the District Court and the Court of Appeals below erred in their decisions of the respective orders and opinions (Appendix "A" and "B") by allowing the dismissal of petitioner's class action (Document 1975) on motion of the respondents, before their answer was interposed, without a hearing on the merits, in violation of the "Due Process of Law" provision of the Fifth Amendment to the Constitution of the United States.

2. Whether the Court of Appeals below erred in its Judgment Order (Appendix "B") affirming the order and judgment of the District Court (Appendix "A"), on the basis of its unrelated and inapplicable decision, "In re Penn Central Transportation Co. (Sales of Park Avenue Properties) Nos. 72-2116-72-2126, (3rd Circuit filed June 14, 1973).

3. Whether the Court of Appeals below erred in its decision and order (Appendix "B") under which it entirely overlooked, failed to speak on, or make reference to the vital and most important issue, of "Depriving the Petitioner and thousands of other bondholders of their property in violation of the Fifth Amendment to the United States Constitution," which was directly and specifically presented on the Appeal.

STATEMENT OF THE CASE.

On June 21, 1970, Penn Central Transportation Company, as debtor, filed a Petition for Reorganization of a Railroad under Section 77 of the Bankruptcy Act, in the United States District Court for the Eastern District of Pennsylvania. The petition was approved by the Court on the same day.

Petitioner-Appellant is the owner of $45,000 face amount and represents seven other owners holding $700,000 of Series A & C Refunding & Improvement Coupon bonds secured by a duly recorded mortgage dated October 1, 1913, issued by New York Central-Hudson River Railroad Co., debtors predecessor. As security for the payment of principal and interest on these bonds, the Mortgagor has granted, conveyed and assigned to the bondholders' Trustee, in addition to certain Railroad lines, all the non-operating real estate, together with all the rents, income and earnings derived therefrom, located in New York and several other states.

Default on the mortgage occurred on October 1, 1970 when the semi-annual interest on the bonds was not paid.

The documentary evidence on file in the District Court discloses that for a period of more than one year, Petitioner-Appellant and her attorney, on several occasions, made written and oral demands upon Morgan Guaranty Trust Co. (Morgan), the Trustee for the bondholders named in the mortgage, to take all necessary legal action or otherwise to protect the interest of the bondholders. Petitioner's class action was filed in the District Court below on October 14, 1971 (Appendix Document 1975 P. 5a) after the receipt of the letter from Morgan's attorneys (Appendix Document 3019 Page 59a) in which Petitioner's attorney was encouraged "to pursue vigorously his efforts to assist in protecting the rights of the bondholders."

On November 9, 1971 respondents moved to dismiss the class action (Appendix Document 2149) without interposing an answer to the 15 allegations contained in the complaint. The motion was based upon three untenable grounds: (1) No allegation in the Petition of Compliance with Section 77(p) of the Bankruptcy Act. (2) Petitioner has no standing since a claim on her behalf was made by an indenture trustee pursuant to Section 77(c)(7) of the Bankruptcy Act. (3) Petitioner is precluded by the provisions of the mortgage referred to in the petition from obtaining the relief sought. The motion having been presented to the District Court with a supporting affidavit (Appendix Document 2237) with selective provisions of the mortgage involved and several letters for the purpose of negating some of the allegations of the complaint, must be treated under the established rules of legal procedure as a motion for summary judgment.

Petitioner's answer to the motion to dismiss (Appendix Document 2884, page 47a) and the supporting affidavit of counsel for the Petitioner (Document 2884, page 50a) together with the other pertinent documents on file in the District Court, have definitely established factually and legally that there is no validity whatsoever to the three grounds urged by the respondents on their motion to dismiss.

The most amazing feature of this entire proceeding is that Morgan Guaranty, the trustee for the bondholders under the mortgage involved herein on May 26, 1971, filed its Petition in the District Court (Document 1297) in which it seeks the authority of the Court "to resign as trustee under certain or all of the indentures"—"by reason of conflicts of interest." and in the alternative sought instructions from the Court "as to what steps it should properly take in order to resolve the conflicts of interest among the indentures referred to above."

This petition further states, that Morgan is a participant to the extent of $25,000,000 in a $300,000,000 bank loan to the debtor which is secured by a pledge of the debtor's stock in Pennsylvania Co. and is in default.

In paragraph 10, page 5 of its petition (Document 1297) the trustee for the bondholders in question states . . . (quote) "To the extent that Morgan Guaranty in its individual capacity as a secured creditor, seeks to collect or to realize upon such claim, its interest as such claimant may conflict with the interests of each of the various classes of bondholders for whom Morgan Guaranty acts as a fiduciary."

As relates to appellant's cause of action, the Morgan petition to the court alleges (Document 1297, Par. 9, Page 4).

"Inevitably, similar conflict of interest problems will arise (i) when segregation studies are conducted and (ii) when plans of reorganization are promulgated. Conflicts of interest can be avoided only by an independent spokesman. Morgan Guaranty believes that provision for such independent representation should be made promptly in order to provide adequate opportunity for such representatives to become familiar with the respective indentures and to prepare to render the services they will be called upon to perform in the future."

There are other glaring conflicts of interest stated in the petition in addition to those quoted here, which clearly disqualified Morgan from acting as a fiduciary trustee for the bondholders, at the time appellant's class action was instituted. In fact, appellant's action served to relieve the bondholders' trustee from its fiduciary responsibility it had as it represented to the District Court.

It is to be noted that the contents of Morgan's petition to the District Court (Document 1297) are extremely mate-

rial to the issues presented on the motion to dismiss appellant's action (Document 2149). Neither the appellant or her attorneys had knowledge of the existence of this document until after all the motion papers were completely served and filed. On the other hand, Morgan, the petitioner in Document 2149, and the debtor's trustees, the moving parties, were totally silent in this regard. They failed to call the court's attention in any of the papers submitted in support of the motion to dismiss, the relevant and most material contents of such important document in the entire proceeding.

The foregoing papers completely invalidate grounds (2) and (3) urged by the respondents on their motion. The remaining ground (1) is based on the absence in petitioner's complaint of an allegation of compliance with Section 77(p) of the Bankruptcy Act, which involves the solicitation of proxies or authorizations to represent creditors or shareholders in a proceeding under the act. It clearly appears that this ground is without merit and inapplicable to this proceedings for the reason that petitioner's action was instituted as a matter of right, without any solicitation of proxies or authorizations from anyone being involved.

The only other ground relied upon by the District Court to dismiss the action is "For the reasons set forth in opinion and order No. 974, an order will be entered denying the petition for sequestration." (Appendix Document 4560 page 121a).

This refers to another and separate proceeding instituted by a combination of three banks including Morgan in the District Court below on February 23, 1972 (Document 2672) more than four months after Petitioner filed her class action and before a decision was made on the motion to dismiss. This proceeding involves a number of

unrelated Mortgages except that Morgan appears therein as trustee for the R&I mortgage (Document 2672 Par. 3) which is the same mortgage involved in petitioner's class action.

The appellant here was not a party to that proceeding nor received any notice relating thereto.

Moreover when the petition of three banks was filed to sequester rents generated from different mortgaged properties, until the final order was entered therein (Document 4528, Page 107a), Morgan, by its own filed documents in the District Court, was completely disqualified to act as trustee for the bondholders under the mortgage involved here. In addition there is asserted in the petition of the three banks, a specific conflict of interest by Morgan as Trustee, as to superiority of rights relating to the Harlem Mortgages (Document 2672, pages 17-19).

Furthermore the petition of the three bank trustees, for sequestration of rents (Document 2672) failed to assert the vital and important issues of "Depriving the bondholders of their property in violation of the Fifth Amendment to the Constitution," and the impairment of the bondholder's substantive rights by respondents' failure to pay the taxes on the no-rail mortgaged properties, thereby creating a superior lien. These issues were specifically asserted and raised in petitioner's class action (Document 1975 Paragraphs 12 and 15). In view of the above mentioned facts and documents, the District Court erred when it dismissed the Appellant's class action based on its opinion and order 974.

On the Appeal to the Third Circuit Court of Appeals, the opinion and order of the District Court was affirmed without comment or reference to the important and substantial constitutional issues specifically presented on the Appeal. The affirmance is based on the decision of the same

Circuit Court, "In re Penn Central Transportation (Sale of Park Avenue Properties), Nos. 72-2116-72-2126 (3rd Cir., filed June 14, 1973) unreported at this time. This decision only involved the sale of six non-rail properties for a total of 59 million dollars (Appendix Exhibit "B"), and is entirely not applicable to the substantial and constitutional issues presented on the Appeal. Therefore the court below was in error when it affirmed the opinion and order of the District Court (Appendix Exhibit "B").

REASONS FOR GRANTING THE WRIT.

---

(1) Petitioner Appellant's Class Action in the District Court and in the Appeals Court Below, Specifically and Directly Raised the Fundamental and Important Constitutional Issue of the "Taking the Property of the Bondholders in Question of the Value in Excess of 100 Million Dollars (Up to May 1972) by the Respondents, During the Pendency of the Reorganization Proceedings and Their Continuing This Practice," Contrary to the Applicable Decisions of the Supreme Court and in Clear Violation of the Provision of the Fifth Amendment to the Constitution of the United States.

The facts and circumstances related to this important issue are supported by the documents and papers presented to the Courts below. The District Court in its opinion and order No. 988 and the Appeals Court Judgment and Order of Affirmance (dated June 22, 1973) do not contain any reference, comment or statement relating to this vital issue. It has been entirely avoided by the Courts below.

The Supreme Court in the applicable case of *Louisville Joint Stock Land Bank v. Radford*, 295 U. S. at Page 602, laid down the rule of law in clear language.

> "For the Fifth Amendment commands that, however great the Nation's need, private property shall not be thus taken even for a wholly public use without just compensation. If the public interest requires and permits, the taking of property of individual mortgagees in order to relieve the necessities of individual mortgagors, resort must be had to proceedings by eminent domain; so that through taxation, the burden of the

relief afforded in the public interest may be borne by the public."

The principle of law above quoted was followed by this Court in *Wright v. Mountain Trust Bank*, 300 U. S. 400-470 where the new amended Frazier-Lemke Act was held valid because it was free from the objectionable features which had been held fatal and unconstitutional to the original act.

In the leading case of *Continental Illinois National Bank v. Chicago, Rock Island & P. Ry. Co.*, 294 U. S. 648 on the subject of railroad reorganization proceedings under Section 77 of the Bankruptcy Act, the issue involved a stay of action for a reasonable time by a secured creditor from enforcing his rights of sale of the security held. The stay was granted in order to afford the debtor a reasonable time to submit a plan of reorganization. However, the Court held that neither Congress nor the Courts have power under the Bankruptcy Act to modify or impair the interest of secured creditors in mortgaged property.

All the Federal District and Circuit Courts of Appeals have uniformly held that Congress and the Courts have no authority to take or confiscate a property right belonging to a secured creditor without violating the Fifth Amendment.

Bindeil v. Liberty Trust Co., 248 F. 112-114 (3d Cir. 1917); *Associated Co. v. Greenhut*, 66 F. 2d 428-429 (3d Cir. 1933); *In re Franklin Garden Apartments*, 124 F. 2d 451-454 (2d Cir. 1941); *Reconstruction Finance Corp. v. Kaplan*, 185 F. 2d 791-796 (1st Cir. 1950); *In re Third Ave. Transit Corp.*, 198 F. 2d 703, 707 (2d Cir. 1952).

The opinion and order of the District Court which denies appellants the right to sequester the rents is con-

trary to its own decision in Order No. 15 (Document No. 110) in the same proceeding. In this matter the District Court directed that rentals derived by the debtor from certain non-rail properties be placed in escrow on the basis of the claim of an assignment of these rentals held by the noteholders, of the Pennsylvania Tunnel and Terminal RR Co. ("PTT"). The rights of the "P. T. T." noteholders to the rentals, are based on an assignment of these rentals as security for the payment of $50 million secured notes issued by P. T. T., a subsidiary of the debtor. This assignment is identical with the same legal effect as the assignment of the rents to the bondholders trustee provided in the mortgage involved here. The District Court having granted escrow of rentals to the P. T. T. noteholders, it was error and contrary to every principle of equity to deny the same relief requested in Petitioner's class action.

(2) The Orders of the Courts Below (Appendix "A" and "B") Are Repugnant to the Due Process Clause of the Fifth Amendment to the Constitution.

Petitioner's class action was filed in the District Court on October 14, 1971 (Appendix 1975 Page 5a) on behalf of herself and thousands of bondholders similarly situated, after demands were made upon the Trustee of the Bondholders for a period of more than a year to take such action. The record in the District Court discloses that the documents filed and by its own admission in writing, the bondholders' Trustee was entirely disqualified to act in the matter. Under these circumstances Petitioner's class action was most appropriate as she had the legal right to maintain and prosecute same.

In cases where much less conflict of interest existed by a Trustee as here, bondholders were allowed to act.

Farmer's Loan & Trust Co. v. Northern Pack. Co., 66 Fed. 169 (1895); *Rabinowitz v. Kaiser Frazer Corp.*, 111 N. Y. S. 2d 539 (1952); *Campbell v. Hudson & Manhattan R. R. Co.*, 102 N. Y. S. 2d 878 (1951); *Borg v. New York Majestic Corp.*, 139 N. Y. S. 2d 72 (1954).

The Appellant having fully established by the records on file in the District Court that she had a legal right to maintain her action, the courts below, by their orders of dismissal and affirmance, deprived the bondholders of their right to the due process clause of the Fifth Amendment to the Constitution.

The leading case decided by this Court on this subject is *Schechter v. U. S. of America*, 295 U. S. 495 (Hughes & Cardozo, J. J.) where this Court held that "Extraordinary conditions do not create or enlarge constitutional power and cannot justify governmental action outside of constitutional authority" and is therefore repugnant to the *due process clause* of the Fifth Amendment.

(3) This Reorganization Proceeding Effecting the Largest Railroad in the Country and the Unusual Number of Other Rail Lines Now Involved in Similar Proceedings Concerns an Important Economic Situation Affecting the Entire Nation.

Congress, the Courts and all the Federal supervisory agencies are overtaxed with the difficult problems presented, in efforts to find a solution. Billions of taxpayers and secured and general creditors funds are expended for the purpose of keeping these railroads alive and in operation. However with the advent of the automobile and airplane, the railroads with few exceptions, have become obsolete.

In view of the national interest, it is respectfully submitted that this Court should have an opportunity to review the orders in question in order to determine whether

the extraordinary conditions existing with relation to the railroads justify the taking and diverting of the property of thousands of bondholders of the value in excess of 150 million dollars at this date.

For the foregoing reasons it is respectfully urged that the petition for certiorari should be granted.

Respectfully submitted,

MAX ROTHENBERG,
Attorney for Petitioner.

August 20, 1973

APPENDIX "A".

IN THE
UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

IN PROCEEDINGS FOR THE REORGANIZATION OF A RAILROAD
BKY. No. 70-347

IN THE MATTER OF
PENN CENTRAL TRANSPORTATION COMPANY,
Debtor

Opinion and Order No. 988.

[Re: Petition of Harriet Signer]

FULLAM, *J.* October 26, 1972

Two related petitions by one Harriet Signer, a holder of bonds issued by the Debtor, secured by the R&I mortgage, evidence a certain amount of confusion as to the applicability of the Federal Rules of Civil Procedure to a railroad reorganization proceeding under § 77 of the Bankruptcy Act.

The first petition (Document No. 1975) seeks an order for the sequestration of certain rents, in order to pay mortgage bond interest, real estate taxes and other charges. This petition purports to be a class action under Rule 23 of the Rules of Civil Procedure, and alleges that it is brought by the petitioner

> ". . . on her own behalf and on behalf of all other holders of Series A and Series C debentures . . . simi-

larly situated. The holders of the aforesaid debentures, on information and belief, number some thousands and it is, therefore, impractical to bring all of them before the court. The questions of law and fact involved herein are common to the entire class, the claim of petitioner is typical of the claims of the entire class, and petitioner will fairly and adequately protect the interest of the entire class of persons holding the aforesaid debentures." (Petition, paragraph 3.)

The petition contains further allegations to the effect that petitioner requested the Morgan Guaranty Trust Company, indenture trustee of the R&I mortgage, to bring legal action to obtain sequestration of the rents, but that the indenture trustee had failed and refused so to act.

Thereafter, petitioner filed a motion seeking to compel the joinder of Morgan Guaranty "as an involuntary party plaintiff" (Document No. 2548), apparently seeking to compel Morgan Guaranty to join in the earlier petition, which the petitioner persisted in treating as if it were a separate plenary suit.

The merits of both of these petitions has effectively been decided. Morgan Guaranty later filed its own petition for sequestration of rents, hearings were held at which both Morgan Guaranty and Harriet Signer appeared through counsel and presented their views, and, as set forth in Opinion and Order No. 974, sequestration of rents has been denied. However, it remains for the Court to enter an order formally disposing of the separate Signer petition, which, in a supplemental memorandum filed October 16, 1972, is referred to as if it were a class action on behalf of a limited class of eight bondholders (not otherwise identified), and, perhaps, as some sort of an application for some kind of intervention.

It is apparent that, on the present record, both of the Signer petitions must be regarded as having been filed on behalf of the petitioner as an individual, and not otherwise. Rule 81(a)(1) of the Federal Rules of Civil Procedure provides that the Federal Rules are not applicable to bankruptcy proceedings except as specifically ordered by the Supreme Court. General Order No. 49(2) of the General Orders in Bankruptcy provides that the General Orders in Bankruptcy apply to railroad reorganization proceedings "in so far as they are not inconsistent with § 77" (with certain exceptions not presently pertinent). General Order No. 37 provides:

> "In proceedings under the Act, the Rules of Civil Procedure for the District Courts of the United States shall, in so far as they are not inconsistent with the Act or with these general orders, be followed as nearly as may be. But the Court may shorten the limitations of time prescribed so as to expedite hearings, and may otherwise modify the rules for the preparation or hearing of any particular proceeding."

It is unnecessary to decide the broad question of whether Fed. R. Civ. Proc. 23, governing class actions, has any application at all to railroad reorganization proceedings. Since § 77(p) of the Bankruptcy Act contains lengthy and detailed provisions governing the extent to which one person may act on behalf of others in reorganization proceedings (generally, not without the express approval and authorization of the Interstate Commerce Commission, except in the case of unsolicited groups not more than 25 in number), and since it is clear that these provisions are squarely inconsistent with this petitioner's original attempt to act on behalf of a class consisting of thousands of bondholders, the conclusion is inescapable that, at the very least,

Rule 23 cannot be applied in this reorganization proceeding to the extent originally sought by the petitioner

There has been no formal amendment of the Signer petition. Nevertheless, statements made at oral argument, and in the supplemental memorandum recently filed, suggest that the petitioner now seeks to act on behalf of a group of only eight bondholders. Rule 23 cannot be applied to justify this approach either, since the "class" is not identified, is not shown to have common interests which would set this group apart from the other thousands of bondholders, and, in any event, is not so numerous that joinder would be impracticable. Moreover, it would seem that the indenture trustee is the appropriate representative.

For all of these reasons, Rule 23 may be disregarded. What remains, then, is a petition by a single bondholder owning some $45,000 worth of bonds (or, perhaps, a petition, within the limitations set forth in § 77(p) of the Bankruptcy Act, on behalf of a group of eight bondholders with combined holdings of $740,000), out of a total issue in excess of $250 million. It is clear that the petitioner, whether acting for herself or for the group of eight bondholders, lacks standing to require general intervention.

Whether the petitioner had a right to be heard is now moot, since she was in fact accorded that right. For the reasons set forth in Opinion and Order No. 974, an order will be entered denying the petition for sequestration. The petition for compulsory joinder of Morgan Guaranty will be dismissed as moot. And, for the reasons set forth above, petitioner's informal request for leave to intervene in these proceedings will be denied.

ORDER No. 988.

AND NOW, this 26th day of October, 1972, it is ORDERED:

1. That, for the reasons set forth in Opinion and Order No. 974, the petition of Harriet Signer for sequestration of rents (Document No. 1975) is DENIED.

2. That the petition of Harriet Signer for compulsory joinder of Morgan Guaranty Trust Company as a "party plaintiff" (Document No. 2548) is dismissed as moot.

3. That the application of Harriet R. Signer for leave to intervene generally in these proceedings is hereby DENIED.

JOHN P. FULLAM, *J.*

APPENDIX "B".

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT.

No. 72-2127.

IN THE MATTER OF
PENN CENTRAL TRANSPORTATION COMPANY,
Debtor,

HARRIET SIGNER,
Appellant.

APPEAL FROM ORDER NO. 988 OF THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

Submitted Under Third Circuit Rule 12(6)
Monday, June 18, 1973.

Before: ADAMS, GIBBONS and WEIS, JR., *Circuit Judges.*

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Attorneys for Morgan Guaranty Trust Company of New York, as Indenture Trustee.

Judgment Order.

After considering appellant Signer's contentions that the district court erred in denying appellant's motion to intervene or to proceed as a representative of a class in litigation seeking the sequestration of certain rents and income received from non-operating properties by the Trustees of the Penn Central, and in view of the fact that this Court has determined that sequestration of said rents and income is not required, *In the Matter of Penn Central Transportation Company* (Sale of Park Avenue Properties), Nos. 72-2116-72-2126 (3d Cir., filed June 14, 1973) at 25, it is hereby

ORDERED AND ADJUDGED that the judgment of the district court is affirmed. Costs taxed against appellant.

By the Court,

ARLIN M. ADAMS,
Circuit Judge.

Attest:

THOMAS F. QUINN,
Clerk.

Dated: June 22, 1973.

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MICHAEL RODAK, JR., CLERK

No. 73-469

IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

HARRIET SIGNER, *Petitioner*

v.

TRUSTEES OF THE PROPERTY OF PENN CENTRAL TRANSPORTATION COMPANY, DEBTOR, *Respondents*

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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TABLE OF CONTENTS

	Page
Opinions Below	2
Statement of the Case	3
Reasons for Denial of the Writ	4
Conclusion	6
Appendix	
Excerpts from Opinion and Order No. 974 of the District Court	1a
Order No. 979 of the District Court	9a
Excerpt from Opinion of the Court of Appeals on Appeals from Orders Nos. 974-77 and 980	10a

TABLE OF CITATIONS

Central Hanover B. & T. Co. v. Philadelphia & Reading Coal & Iron Co., 99 F.2d 642 (3rd Cir. 1938)	5
Continental Illinois Nat. Bank & Trust Co. v. Chicago, Rock Island & P. Ry., 294 U.S. 648 1935)	4
In re Philadelphia & Reading Coal & Iron Co., 117 F.2d 976 (3rd Cir. 1941)	5
R.F.C. v. Kaplan, 185 F.2d 791 (1st Cir. 1951)	6
6A Collier on Bankruptcy, 14.03[1] (14th ed)	6

IN THE

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No. 73-469

HARRIET SIGNER, *Petitioner*

v.

TRUSTEES OF THE PROPERTY OF PENN CENTRAL TRANSPORTATION COMPANY, DEBTOR, *Respondents*

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

George P. Baker, Richard C. Bond and Jervis Langdon, Jr., Trustees of the Property of Penn Central Transportation Company, Debtor (Respondents), submit this brief in opposition to the Petition of Harriet Signer (Petitioner) for a Writ of Certiorari to review a judgment of the Circuit Court of Appeals for the Third Circuit. That judgment affirmed an order of the District Court for the Eastern District of Pennsylvania in the proceedings for

reorganization of Penn Central Transportation Company, Debtor (Penn Central), denying Petitioner's application for sequestration of the income from certain nonoperating properties of Penn Central mortgaged to secure bonds held by petitioner.

All the contentions raised by the Petition for Certiorari have been fully considered by the Courts below and disposed of adversely to Petitioner in accordance with controlling principles established by this Court and the Circuit Courts of Appeals. The Petition should therefore be denied.

OPINIONS BELOW

The opinion of the District Court is reported at 354 F. Supp. 757 and is printed as Appendix A to the Petition. The Judgment Order of the Court of Appeals affirming the District Court is printed as Appendix B to the Petition. The opinion of the District Court refers to its Opinion and Order No. 974, reported at 354 F. Supp. 717, for a statement of the grounds for its action. Relevant excerpts from this opinion are printed in the appendix to this brief. (RA 1-9). Similarly, the Judgment Order of the Court of Appeals refers to its opinion in *In the Matter of Penn Central Transportation Company, Morgan Guaranty Trust Company of New York, et al., Appellants,* to explain the grounds for its judgment. The relevant excerpt from that opinion also appears in the appendix to this brief (RA 10-11).

Page references preceded by the letter "A" herein are to the Appendix to the Petition and page references preceded by the letters "RA" are to the appendix to this brief.

STATEMENT OF CASE

The facts relevant to the issues sought to be raised by the petition can be simply stated. Petitioner owns $40,000 in principal amount, and purports to speak for seven additional persons holding an additional $700,000 in principal amount, out of a total of more than $250,000,000 of bonds outstanding under the Refunding and Improvement Mortgage dated October 1, 1913 (the R & I Mortgage) of New York Central and Hudson River Railroad Company (New York Central), a predecessor of Penn Central (A 4). The R & I Mortgage and two prior mortgages of the New York Central (collectively the Hudson River Mortgages) are liens on valuable non-railroad real estate of Penn Central located in New York City (the Park Avenue Properties) and also on large portions of the Penn Central railroad system (RA 3). No interest has been paid on bonds outstanding under the Hudson River Mortgages since the filing of Penn Central's petition for reorganization in June 1970. The Trustees have been collecting income from Park Avenue Properties and applying it, along with other available funds, to expenses incurred by the Trustees in operating the Penn Central railroad system. It is estimated that losses on railroad lines subject to the Hudson River Mortgages exceed the cash flow from the Park Avenue Properties (RA 3, 6).

In October 1971 Petitioner filed in the reorganization proceedings a petition seeking sequestration of the income of the Park Avenue Properties and its application to payment of state and local taxes on the Properties and interest on the R & I Bonds. Before any hearing was held on this petition the trustees

under the three Hudson River Mortgages filed a joint petition seeking the same relief. The Penn Central Trustees answered and a full evidentiary hearing was held. Notwithstanding the assertion in the Petition for Certiorari that "appellant here was not a party to that proceeding nor received any notice relating thereto," Mrs. Signer appeared through counsel at the hearing and was granted leave to and did file a brief in support of sequestration (A 1-2, RA 6-7). A further hearing was held solely on the Signer petition prior to its denial by Order No. 988 of the District Court.

The District Court concluded that "sequestration of the income from the Park Avenue Properties would substantially impair the ability of the Debtor to reorganize and to provide continued rail service" (RA 8-9), and denied the petitions for sequestration (A 4-5, RA 9).

REASONS FOR DENIAL OF THE WRIT

The petitioner's contention, stripped of procedural details, is simply that permitting a debtor in reorganization to use the income of mortgaged properties to support operations of the debtor pending reorganization amounts to an unconstitutional taking of property without due process of law.

The law is clear to the contrary. In *Continental Illinois Nat. Bank & Trust Co.* v. *Chicago, Rock Island & P. Ry.*, 294 U.S. 648 (1935), this Court established the principle that in a reorganization the remedies of a secured creditor may be deferred to afford a reasonable opportunity to work out a plan of reorganization. The Court of Appeals for the

Third Circuit has twice applied that principle to petitions for sequestration of income of mortgaged or pledged property of a debtor in reorganization. In *Central Hanover B. & T. Co.* v. *Philadelphia & Reading Coal & Iron Co.*, 99 F.2d 642 (3rd Cir. 1938), involving income from operating properties, the Court said (99 F.2d at 645):

> ". . . it was entirely proper for the court below to refuse to order the physical sequestration and impounding by the Debtor for the benefit of the bondholders of the income of the mortgaged property. It is clear that the court in so doing did not deprive the appellant or the bondholders it represents of their property without due process of law in violation of the fifth amendment. Continental Illinois Nat. Bank. & Trust Co. v. Chicago, Rock Island & P. Ry. Co., *supra;* Wright v. Vinton Branch, 300 U.S. 440, 57 S. Ct. 556, 81 L.Ed. 736, 112 A.L.R. 1455."

In re Philadelphia & Reading Coal & Iron Co., 117 F.2d 976 (3rd Cir. 1941) involved sequestration of dividends on shares of pledged stock and interest on pledged bonds. The Court said (117 F.2d at 979):

> "In order to effectuate the policies of the Bankruptcy Act a debtor undergoing reorganization should be permitted to receive and retain during the reorganization proceeding the income from its mortgaged and pledged property which under the terms of the mortgage or pledge it had been permitted to enjoy prior thereto, *unless the court is satisfied that the retaking* of the income or part of it by the mortgagee or pledgee *will not prejudice the operation of the business of the debtor* during the reorganization proceeding." (Emphasis added.)

In the present case the District Court affirmatively found that the income sought to be sequestered was needed to assure continued rail operation pending reorganization (RA 6, 8-9).

See also *R.F.C.* v. *Kaplan,* 185 F.2d 791 (1st Cir. 1951); 6A Collier on Bankruptcy, § 14.03[1] (14th ed).

No case cited by Petitioner even remotely supports her contentions. Indicative of the absence of any real merit to her legal position is the fact that, faced with the findings made by the District Court, none of the Hudson River Mortgage trustees appealed the order denying their sequestration petition.

CONCLUSION

The petition for certiorari raises no issues meriting review by this Court and should be denied.

Respectfully submitted,

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Attorneys for the Trustees of the Property of Penn Central Transportation Company

Dated: September 28, 1973

APPENDIX

UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

In the Matter of

PENN CENTRAL TRANSPORTATION COMPANY, Debtor

In Proceedings for the Reorganization of a Railroad

Pla. No. 70,347

APPENDIX

OPINION AND ORDER NO. 974

[Re: Sale of Park Avenue Properties]

PUTNAM, J. October 20, 1972

* * * * * * * * * * *

INTRODUCTION

The Trustees seek authorization to sell certain major real estate holdings of the Debtor located in the Park Avenue area of the City of New York, for prices totalling $59,540,000. Conditional or absolute objections to some or all of the proposed sales have been interposed by several interested parties, on a variety of legal and factual grounds.

The following issues, directly or indirectly related to the proposed sales, are presented for decision:

* * * * * * * * * * *

[illegible] case the District Court affirmatively [illegible] the income sought to be sequestered was [illegible] to assure continued rail operation pending reorganization (RA 6, 8-9).

See also *N.Y.C. v. Kaplan*, 185 F.2d 791 (1st Cir. 1951); 6A Collier on Bankruptcy, §14.03[1] (14th ed.).

No case cited by Petitioner even remotely supports her contentions. Indicative of the absence of any real merit to her legal position is the fact that, faced with the findings made by the District Court, none of the Hudson River Mortgage trustees appealed the order denying their sequestration petition.

APPENDIX

CONCLUSION

The petition for certiorari raises no issues meriting review by this Court, and should be denied.

Respectfully submitted,

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Dated: September 28, 1973

APPENDIX

UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

In the Matter of

PENN CENTRAL TRANSPORTATION COMPANY, Debtor

In Proceedings for the Reorganization of a Railroad

Bky. No. 70-347

OPINION AND ORDER NO. 974

[Re: Sale of Park Avenue Properties]

FULLAM, J. October 20, 1972

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INTRODUCTION

The Trustees seek authorization to sell certain major real estate holdings of the Debtor located in the Park Avenue area of the City of New York, for prices totalling $59,549,000. Conditional or absolute objections to some or all of the proposed sales have been interposed by several interested parties, on a variety of legal and factual grounds.

The following issues, directly or indirectly related to the proposed sales, are presented for decision:

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4. Are the trustees entitled to use the income from the properties for operating expenses, or must the income be sequestered, either

(a) by reason of the rights of the New Haven trustee? or

(b) by reason of the rights of certain indenture trustees?

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FINDINGS OF FACT

1. The Debtor's estate includes various real estate holdings in the Borough of Manhattan, in the City of New York, commonly known as the Park Avenue Properties (the "Properties").

2. In general, the Debtor has constructed rail facilities below the street level of these properties. The use of the subsurface rights for the Debtor's rail operations has not detrimentally affected the value or usefulness of the surface and air rights for commercial development.

3. The Properties have been developed during this century for office or hotel use.

4. The Debtor's interests in the Properties are of two kinds: fee interests originally acquired by the Debtor's corporate predecessors; and leasehold rights under a 401-year lease executed in 1873 by the New York and Harlem Railroad Company (the "Harlem") in favor of the New York Central and Hudson River Railroad Company. Certain of the Properties were developed on parcels in which the Debtor has combined fee and leasehold rights.

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8. The annual cash flow to the Debtor from the Properties is subject to fluctuations occasioned by the participation provisions or similar arrangements found in many of the ground leases. The actual rental payment received by the Debtor from the Properties exclusive of tax pay-

ments made directly to the City of New York under the respective leases or pursuant to orders of this Court is approximately $20 million to $22 million per annum. Capital improvements to the hotels cost the Debtor between $2 million and $3.5 million per annum, and the Debtor's annual tax liabilities on the Properties, over and above taxes paid directly by the lessees total approximately $6.5 million per annum.

9. Assuming continued deferral of taxes, the annual cash flow from the Properties is in the area of $16 to $17 million. If taxes were to be paid on a current basis, the cash flow would be about $10 to $11 million per year.

10. The Trustees' fee interests and leasehold rights in the Properties are subject to three mortgages known as the Hudson River Mortgages:

a. The New York Central & Hudson River Railroad Company 3½% mortgage dated June 1, 1897;

b. The New York Central and Hudson River Railroad Company Consolidated Mortgage dated June 20, 1913;

c. The New York Central and Hudson River Railroad Company Refunding and Improvement Mortgage dated October 1, 1913 ("R & I Mortgage").

11. Security for the Hudson River Mortgages consists in part of approximately 2,000 route miles and 4,000 track miles of the Central's operating property east of Buffalo. The R & I Mortgage is also secured by a lien of various rankings on an additional 1,700 route miles and 3,500 track miles as well as a lien on the Debtor's leasehold rights under six lease agreements covering 2,300 route miles and 4,200 track miles.

12. Definitive segregation studies are not available to determine the losses incurred by various segments of the Debtor's system. It is estimated that the losses on the line constituting the security for the Hudson River Mortgages

is equal to or greater than the annual cash flow from Park Avenue Properties.

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B. Affirmance Conditions

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2. Payment of Dividends on the Debtor's Harlem Stock, Pledged with the Trustee of the R&I Mortgage

The R&I Mortgage constitutes a lien on most of the real estate formerly owned by the New York Central, now owned by the Debtor. In addition, the R&I indenture trustee holds the Debtor's Harlem stock as collateral security (Finding No. 78). Under the terms of the R&I indenture, in the event of default the indenture trustee is entitled to receive dividends on the pledged stock and apply them to the mortgage debt. Under the Third Supplemental Contract to the Harlem lease, the Debtor is excused from paying that portion of the rental representing $5 per share per year on stock owned by the Debtor, only if the R&I indenture trustee is not entitled to receive the dividends under the mortgage. The annual dividends on the pledged stock would amount to about $950,000.

Morgan Guaranty, as indenture trustee of the R&I mortgage, contends that, as a condition of affirmance of the Harlem lease, the Trustees must either pay all arrearages and continue to pay currently the dividends on the pledged stock, or acknowledge that Morgan's claim to these dividends ranks as an administration claim.

It should be noted at the outset that the resolution of this phase of the controversy will not affect the lessor. Under any view of the matter, the ultimate issue is whether dividends on pledged stock should be paid over to the pledgee, or retained by the pledgor to meet operating expenses. Thus, even if it were to be held that, for purposes of formal compliance with the rental requirements of the lease, the Trustees should pay rental calculated on the ba-

sis of paying dividends on all of the Harlem stock, the issue would still remain whether the Harlem should pay these dividends to the Trustees/pledgors, or to Morgan Guaranty/pledgee. Whatever rights Morgan has to receive the dividends arise under the R&I indenture and the pledge agreement; its claims are against the Debtor, not the Harlem.

It is clear that a reorganization court may properly order that dividends on pledged securities be paid to the Debtor's estate and expended for operating purposes. *R.F.C.* v. *Kaplan,* 185 F.2d 791 (1st Cir. 1951); 6A Collier on Bankruptcy, § 14.03[1] (14th ed.) and cases cited therein. Morgan's argument is virtually identical to the argument rejected by the Third Circuit in *In re Philadelphia & Reading Coal & Iron Co.,* 117 F.2d 976 (3d 1941). In that case, Judge Maris concluded that there is no justification for treating income from pledged stock any differently than income from real property subject to a mortgage lien, *Central Hanover Bank & Trust Co.* v. *Philadelphia & Reading Coal & Iron Co.,* 99 F. 2d 642 (3d Cir. 1938); and that it was appropriate for a reorganization court to suspend a pledgee's contractual right to receive the income from pledged securities, and to permit the trustees to use the income to support the current operations of the debtor, if the income was needed for that purpose. *See also In re Philadelphia Coal & Iron Co.,* 141 F.2d 954 (3d Cir. 1944); *In re Industrial Office Building Corp.,* 171 F.2d 890 (3d Cir. 1949).

That the Trustees need this income to assure continued rail operations pending reorganization cannot be doubted. While the results of Debtor's current operations continue to improve, the Trustees have not yet been able to resume payment of current real estate taxes. Because of seasonal fluctuations, cash flow projections remain marginal. The cash drain occasioned by tropical storm Agnes has been severe. In application of the principles set forth in the

cases cited above, I have concluded that the Trustees should retain the benefit of the dividends on the pledged Harlem stock.

I express no view as to whether Morgan Guaranty is entitled to administration claim status in connection with these deferred dividend payments. I believe all such matters should be resolved in connection with the proof of claims program and the plan of reorganization.

* * * * * * * * * *

D. Other Petitions to Sequester Income

The Hudson River Mortgage trustees represent bondholders under three of the Central's major bond issues (Finding No. 9). These mortgages are secured by substantial parts of the rail properties east of Buffalo, and by the Debtor's fee and leasehold interests in the Park Avenue Properties (Findings 5 and 6). Interest on the bonds has not been paid since reorganization, and the Debtor's portion of real estate taxes has not been paid. Under Order No. 1, the mortgage trustees are enjoined from exercising their remedies under the mortgage by reason of these defaults.

The Park Avenue Properties generate substantial amounts of income. Although the record is, unfortunately, not clear as to the precise amount of net income derived therefrom, the amount is at least $10 million annually. The Trustees have been using this income for general operating expenses. The Hudson Mortgage trustees (and, in a separate petition, an individual bondholder, Harriet Signer) have petitioned for sequestration of the income from the properties. The petitioners request that this income be escrowed for the benefit of the Hudson River bondholders (subject to certain claims of the Harlem bondholders) and that there be an accounting of all post-reorganization income, and a declaration of administration claim status for the income thus far expended by the Trustees.

The basic issue is this: Does a § 77 reorganization court have constitutional and statutory power to permit the Trustees of the Debtor railroad to use for operational expenses during the period before a plan of reorganization is filed, income generated by real property subject to mortgage liens; and, if so, should such permission be extended under the present circumstances?

In many respects, the same considerations are applicable here as were discussed in Part I (B)(2) of this opinion, in connection with the treatment of dividends on pledged stock.

While a reorganization court undoubtedly has the power to require that income from mortgaged property be paid to the mortgage trustees, *Missouri Pacific Ry. Co. 5¼% Secured Serial Bondholders Committee* v. *Thompson,* 149 F.2d 799 (8th Cir. 1952), or to restrict the use of rental income by the Trustees of the Debtor, *In re Franklin Garden Apartments,* 124 F.2d 451 (2d Cir. 1941), it is at least equally clear that a reorganization court does have the power to permit the Debtor's Trustees to use this income for operating expenses. *In re Philadelphia & Reading Coal & Iron Co.,* 117 F.2d 976 (3d Cir. 1941); *see also Central Hanover Bank & Trust Co.,* 99 F.2d 642 (3d Cir. 1938; 6A Collier on Bankruptcy, § 14.03 [1] (14th ed).

The Signer brief argues that the Third Circuit decisions just cited are an aberration and should be disregarded in this proceeding in view of the decision of the Supreme Court in *Louisville Joint Stock Land Bank* v. *Radford,* 295 U.S. 555 (1935). The *Radford* case held that the original Frazier-Lemke Act (granting farmers certain relief from foreclosures) was unconstitutional. However, a second Frazier-Lemke Act was passed in 1935, and its constitutionality was upheld in *Wright* v. *Vinton Branch,* 300 U.S. 440 (1937) (not cited or referred to in the Signer brief). The *Philadelphia & Reading Coal & Iron Co.* cases were decided by the Third Circuit Court shortly after the *Rad-*

ford decision by the Supreme Court. There is nothing in *Radford* which undercuts the holdings of the Third Circuit on the propriety of permitting a debtor in reorganization to use rental income for operational expenses. Needless to say, the same is true of *Wright* v. *Vinton Branch.*

The Hudson River Mortgage trustees argue that denial of their present petition would violate their vested property interests, by reason of the fact that unpaid real estate taxes are accruing on the properties, and impair their security. The short answer to this argument is that the *claim* of the bondholders is not diminished by the prior tax liens on the property, nor would the value of their security for purposes of the plan be affected by the existence of the tax liens. If the mortgage trustees' theory were adopted, it would follow that § 77 relief would be available only to a railroad whose financial difficulties were confined to an overburdened capital structure. In a case such as the present one, where operations do not generate sufficent cash to cover all real estate taxes, temporary deferral of taxes is a necessity. Order No. 70 herein, authorizing deferral of taxes, has been upheld on appeal (452 F.2d 1107 (3d Cir. 1971), *cert. denied,* 406 U.S. 944 (1972). The essence of these decisions is that, consistent with the provisions of §77, it is appropriate to provide the Trustees some "breathing room" so that, in their efforts to rehabilitate the Debtor, they can, for a reasonable period, use cash which would otherwise have gone to pay taxes, to meet current operating expenses. If the mortgage trustees' argument were to be accepted, the entry of a tax deferral order would serve merely to create grounds for depriving the Trustees of income, and would be self-defeating. In my judgment, there is no basis for imposing such a limitation on the statutory scheme of § 77.

Thus, the real issue is whether sequestration of the income from the Park Avenue Properties would substantially impair the ability of the Debtor to reorganize and to pro-

vide continued rail service. For the reasons summarized in Part I(B)(2) above, I have concluded that it would, and that under the circumstances the Trustees should continue to have the use of this income.

Needless to say, just as in the case of the tax deferral orders, this determination is subject to reconsideration at any time, as circumstances develop.

A final contention is that Order No. 15 herein constitutes the "law of the case," and that denial of the present petitions would be inconsistent with that order. This contention lacks merit. Order No. 15 was entered shortly after reorganization, before the Trustees were appointed; it was entered by consent; it does not purport to be a final determination of any issue, but is merely a "status quo" order designed to prevent irreparable injury while underlying issues are negotiated or litigated. It is expressly subject to being reopened at any time upon the application of any party adversely affected thereby.

The present sequestration petitions will be denied.

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Order No. 979

And Now, this 20th day of October, 1972, for the reasons stated in Part II(D) of Opinion and Order No. 974, it is Ordered that the Petition of the Hudson River Indenture Trustees for sequestration of income from the Park Avenue Properties (Document No. 2672) is Denied.

/s/ John P. Fullam

Excerpt from Opinion of the Third Circuit June 14, 1973

UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

Nos. 72-2116, 72-2117, 72-2118, 72-2119, 72-2120, 72-2121, 72-2122, 72-2123, 72-2124, 72-2125, 72-2126.

In the Matter of:

PENN CENTRAL TRANSPORTATION COMPANY, *Debtor*

MORGAN GUARANTY TRUST COMPANY OF NEW YORK, As Trustee Under Mortgages of New York and Harlem Railroad Company and Under Certain Mortgages of New York Central and Hudson River Railroad Company; MANUFACTURERS HANOVER TRUST COMPANY and BANKERS TRUST COMPANY, Each as Trustee Under a Mortgage of New York Central and Hudson River Railroad Company; RICHARD JOYCE SMITH, As Trustee of the Property of the New York, New Haven & Hartford Railroad Company, Debtor; THE FIDELITY BANK; and PENN CENTRAL COMPANY, *Appellants.*

* * * * * * * * * * *

The Morgan Guaranty, in its capacity as Trustee under the R&I mortgage of the New York Central, contends that it is entitled to rental payments or dividends on the stock of Harlem. Under the R&I mortgage, the shares of the Harlem owned by Penn Central are pledged as security for the bonds. Morgan Guaranty claims that since the R&I bonds are in default, it has foreclosed on the collateral and now is in possession of the Harlem shares. As stated earlier, Penn Central holds title to about 95% of the Harlem shares, the remaining 5% being publicly held. The $5 dividend, or rental payment, due on the 5% of the shares not held by the Penn Central has been paid throughout the reorganization, although no payment has been made on the 95%. Morgan Guaranty asserts that because these shares have passed from the Penn Central to the mortgage trustee as a result of the default, it is entitled either to receive

the dividends accrued and those that come due or to have these claims ranked as an administrative claim.

The district court, relying on this Court's opinion in *In re Philadelphia & Reading Coal & Iron Co.*,[54] held that the income produced by the pledged shares was available to the Trustees of the Penn Central and need not be paid to the pledgee. Having thus denied the claim for immediate payment, the district court deferred a determination of the status to be accorded Morgan Guaranty's claim until the formulation of the reorganization plan. We affirm these holdings of the district court.

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[54] 117 F.2d 976 (3d Cir. 1941).

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MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

October Term, 1973.

No. 73-469.

HARRIET SIGNER,

Petitioner,

v.

TRUSTEES OF THE PROPERTY OF PENN CENTRAL TRANSPORTATION COMPANY, DEBTOR,

Respondents.

PETITIONER'S REPLY BRIEF.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1973.

No. 73-469.

HARRIET SIGNER,

Petitioner,

v.

TRUSTEES OF THE PROPERTY OF PENN CENTRAL TRANSPORTATION CO.,

Respondents.

PETITIONER'S REPLY BRIEF.

Respondents' brief was received by the Attorney for the Petitioner on October 1, 1973. It contains inaccurate and misleading statements relating to the paramount issues presented to this Court so that Petitioner's attorney deems it appropriate to call this Court's attention to same.

(1) On page 2 of Respondents' brief the following conclusory statement is made:

> "All the contentions raised by the Petition for Certiorari have been fully considered by the Courts below and disposed of adversely to Petitioner in accordance with controlling principles established by this Court and the Circuit Courts of Appeals."

The above statement is not only inaccurate but misleading without support in the record of the entire proceeding in the District Court and in the Court of Appeals below.

The fundamental and important constitutional issue was first presented by Petitioner in her class action complaint in the District Court (Document 1975) to which no answer was interposed. On the motion of Respondents, the District Court dismissed the class action without a hearing on the merits, based on three untenable grounds (Appendix "A" 5). No consideration whatever was given or even mentioned in the District Court opinion and order (Appendix "A") pertaining to the constitutional issue.

On the appeal to the Court of Appeals below, the principal issue raised by the Petitioner was "the taking and diverting by the respondents of the rents and income from the non-rail properties subject to the lien of the bondholders mortgage, in violation of the Fifth Amendment to the Constitution." Respondents' brief submitted to the Court of Appeals below is completely silent on this vital issue. The Judgment order of the Court of Appeals (Appendix "B" 7a) is based on two other unrelated appeals, wherein the only issue involved was the sale of non-rail properties. It clearly appears that the Court of Appeals did not consider, mention or pass upon the constitutional issues presented. Under these circumstances, the above quoted statement in Respondents' brief is entirely without support in the record.

(2) Another important inaccuracy appears on page 7a of Respondents' brief, where the following is stated:

> "However, a second Frazier-Lemke Act was passed in 1935, and its constitutionality was upheld in Wright v. Vinton Branch, 300 U. S. 440 (1937) (not cited or referred to in the Signer brief)."

The above quoted statement is misleading and erroneous by reason of the definite assertion on page 11 of Petitioner's brief which states:

"The principle of law above quoted was followed by this Court in Wright v. Mountain Trust Bank, 300 U. S. 400-470 where the new amended Frazier-Lemke Act was held valid because it was free from the objectionable features which had been held fatal and unconstitutional to the original act."

(3) There is annexed to Respondents' brief (10a) a prepared document titled "Excerpt from opinion of the Third Circuit June 14, 1973," which is misleading. These three selected excerpts are extracted out of the context of a 24 page printed opinion rendered by the Third Circuit on June 14, 1973, in eleven unrelated appeals which only involved the proposed sale of four office buildings. The vital constitutional issues presented here, were not referred to, mentioned or raised by any party in all the eleven appeals. It is to be noted that the attorneys for the Respondents here, also appeared as the attorneys for the Appellees in all the eleven unrelated appeals. Respondents' exhibit (10a) set forth in their brief beclouds the issues and leads to confusion with the Judgment and Order of the Third Circuit (Appendix "B" 7a) *dated June 22, 1973* which Petitioner seeks to be reviewed by this Court.

It is therefore submitted that exhibit (10a) annexed to Respondents' brief should be disregarded by the Court.

Respectfully submitted,

MAX ROTHENBERG,
Attorney for Petitioner.

Dated October 4, 1973.